Czech University of Life Sciences Prague

Faculty of Economics and Management

Department of Economics

Diploma Thesis

Financial Analysis of INDITEX

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DIPLOMA THESIS ASSIGNMENT

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Thesis title

Financial analysis of INDITEX

Objectives of thesis

The Diploma Thesis aims to evaluate the financial performance of the multinational clothing company INDITEX.

The work is focused on the effectiveness of the financial and economic activities of the company during the period of 2015-2019. It aims to identify the factors affecting the efficiency of the corporation's financial activities. The analysis follows the purpose of specifying the effect of INDITEX's fast fashion approach to its financial well-being.

As a sub-objective, the research work aims to:
• evaluate the component parts of the company's return on equity;
• determine the financial activities, which are contributing the most to the changes in the return on equity;
• evaluate the current share price of INDITEX;
• test the company's likelihood of bankruptcy.

Methodology

The research consists of theoretical and practical parts. In the theoretical part, the theory behind the thesis is explained. The reviewed literature defines fundamental terms, theories and methods of financial analysis.

The practical part contains the description of the company profile, the industry analysis. It is focused on implementation of financial analysis of INDITEX. Publicly available financial reports are analysed. Historical information is combined with a series of assumptions and adjustments to the financial information. The financial analysis is conducted with the use of horizontal analysis, vertical analysis, Dupont analysis and financial ratios. In the ratio analysis, the focus is on the profitability ratios including many possible decompositions, liquidity ratios and solvency ratios. This work conducts additional financial analysis using Altman's Z-score.

The proposed extent of the thesis

70-80

Keywords

Inditex, fast fashion industry, vertical analysis, horizontal analysis, ratio analysis, DuPont analysis, Altman Z-score, financial statement analysis

Recommended information sources

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Declaration

I declare that I have worked on my diploma thesis titled "Financial Analysis of INDITEX" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the diploma thesis, I declare that the thesis does not break copyrights of any their person.

In Prague on 30.11.2020 _____

Acknowledgement

Financial Analysis of Inditex

Abstract

The topic of this diploma thesis is Financial Analysis of INDITEX, which is one of the leading multinational clothing companies. The work is focused on the effectiveness of the financial and economic activities of the company during the period of 2015-2019. The research consists of theoretical and practical parts. The theoretical part defines fundamental terms, theories and methods of financial analysis. Whilst the practical part contains the description of the company profile, the industry analysis. Publicly available financial reports are used for the financial analysis. Historical information is combined with a series of assumptions and adjustments to the financial information. The financial analysis is conducted with the use of horizontal analysis, vertical analysis, Dupont analysis and financial ratios. In the ratio analysis, the focus is on the profitability ratios including many possible decompositions, liquidity ratios and solvency ratios. The work conducts additional financial analysis using Altman's Z-score as well. The diploma thesis identifies the factors affecting the efficiency of the corporation's financial activities. The analysis specifies the effect of INDITEX's fast fashion approach to its financial well-being. The work also deals with the interpretation of calculated indicators and the strengths and weaknesses of the analyzed company.

Keywords: Inditex, fast fashion industry, vertical analysis, horizontal analysis, ratio analysis, DuPont analysis, Altman Z-score, financial statement analysis

Finanční analýza společnosti INDITEX

Abstrakt

Tématem této diplomové práce je finanční analýza společnosti INDITEX, která je jednou z předních mezinárodních oděvních společností. Práce je zaměřena na nejúčinnější a nejzajímavější vlastnosti společností za období 2015-2019. Výzkum se skládá z teoretické a praktické časti. Teoretická část definuje základní pojmy, teorií a metody finanční analýzy. Praktická část zahrnuje popis profilu společnosti a průmyslovou analýzu. Finanční analýza byla vytvořená s použitím veřejné dostupných zpráv. V práci je kombinována řada předpokladů a úprav finančních informací spolu s historickými informacemi. Finanční analýza je prováděna s využitím horizontální a vertikální analýzy, DuPontového modelu a finančními koeficienty. V poměrové analýze se zaměřuje na ukazatele ziskovosti včetně mnoha možných rozkladů, ukazatelů likvidity a ukazatelů solventnosti. Práce provádí další finanční analýzu také pomocí Altmanovy analýzy. Diplomová práce identifikuje faktory ovlivňující efektivitu finančních aktivit společnosti. Analýza specifikuje účinek rychlého přístupu společnosti INDITEX na její finanční prosperitu. Práce se také zabývá interpretací spočtených indikátorů včetně silné a slabé stránky analyzované společnosti.

Klíčová slova: INDITEX, průmysl rychlé módy, vertikální analýza, horizontální analýza, poměrová analýza, DuPontový model, Altmanová analýza, analýza finančních výkazů

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1   Introduction

The development of the modern economic situation is characterized by exposure to political, social and foreign economic factors. The influence of these factors creates instability in the external environment, where the issue of financial management of the company is very acute. Retailers are particularly affected by this impact. Managing the company's finances in this area is becoming more difficult, as the market is crowded with different brands with the various assortment. The abundance of brands allows the customer to be more demanding to choose a particular brand. In order to maintain consumer interest and attract new buyers, companies are constantly improving an assortment diversity and pricing strategies.

With the purpose to understand the operation of the company's mechanisms and its future development, it is necessary to ensure the information transparency of the enterprise and the predictability of its development. The businesses are interested in limiting the spontaneity of market processes ensuring optimization of costs and profits.

In the 21st century, as an answer to the emerged challenges, the importance of fast fashion brands became apparent. Some of the main fast fashion brands have shown about 15% of annual sales growth within the past 5 years. As we can see the fast fashion market has high growth potential. One of the bright examples is Inditex group (Industria de Diseño Textil, S.A.), which operates in textile design, manufacturing and distribution segments. All operations of the company are contributing to highly competitive fast fashion segment.

According to many experts involved in the study of the fashion market, Inditex is "the most creative and destructive retailer in the world"; while according to journalists, it is "the most research-worthy brand in Europe."

The diploma thesis is focused on evaluating the financial situation of Inditex during the period of 2015-2019. Financial analysis is one of the fundamental aspects for the assessment of the company's financial health. Based on the values of various indicators, it will be possible to assess the company's strength and weaknesses.

2   Objectives and Methodology

2.1   Objectives

The Diploma Thesis aims to evaluate the financial performance of multinational clothing company INDITEX.

The work is focused on the effectiveness of the financial and economic activities of the company during the period of 2015-2019. It aims to identify the factors affecting the efficiency of the corporation's financial activities. The analysis follows the purpose of specifying the effect of INDITEX's fast fashion approach to its financial well-being.

As a sub-objective, the research work aims to:

- evaluate the component parts of a company's return on equity;
- determine the financial activities, which are contributing the most to the changes in the return on equity;
- evaluate the current share price of INDITEX;
- test the company's likelihood of bankruptcy.

2.2   Methodology

The research consists of theoretical and practical parts. In the theoretical part, the theory behind the thesis is explained. The reviewed literature defines fundamental terms, theories and methods of financial analysis.

The practical part contains the description of the company profile, the industry analysis. It is focused on implementation of financial analysis of INDITEX. Publicly available financial reports are analysed. Historical information is combined with a series of assumptions and adjustments to the financial information. The financial analysis is conducted with the use of horizontal analysis, vertical analysis, Dupont analysis and financial ratios. In the ratio analysis, the focus is on the profitability ratios including many possible decompositions, liquidity ratios and solvency ratios. The work conducts additional financial analysis using Altman's Z-score.

The assessment was conducted using the following formulas:

$$Cash\ ratio = \frac{Cash + Shortterm\ Investment}{Current\ Liabilities} \tag{1}$$

$$Quick\ ratio = \frac{Current\ Asset - Inventories}{Current\ Liabilities} \tag{2}$$

$$Current\ ratio = \frac{Current\ Assets}{Current\ Liabilities} \tag{3}$$

$$Current\ ratio = \frac{Cash + Account\ Receivables + Shortterm\ Investment}{Current\ Liabilities} \tag{4}$$

$$ROS = \frac{Net\ Income}{Net\ Sales} \tag{5}$$

$$ROA = \frac{EBIT}{Total\ Assets} \tag{6}$$

$$ROE = \frac{Net\ Income}{Stockholders\ Equity} \tag{7}$$

$$Asset\ Turnover\ ratio = \frac{Sales}{Total\ Assets} \tag{8}$$

$$Inventory\ Turnover\ ratio = \frac{Cost\ of\ Goods\ sold}{Average\ Inventory} \tag{9}$$

$$Receivables\ Turnover\ ratio = \frac{Revenue}{Account\ Receivables} \tag{10}$$

$$Accounts\ Payables\ Turnover = \frac{Purchases}{Accounts\ payable} \tag{11}$$

$$Payable\ Turnover\ period = \frac{Accounts\ Payable\ Turnover}{Revenue/365day} \tag{12}$$

$$Debt\ ratio = \frac{Total\ Liabilities}{Total\ Assets} \qquad (13)$$

$$Equity\ ratio = \frac{Equity}{Total\ Assets} \qquad (14)$$

$$Book\ value = \frac{Equity}{Number\ of\ ordinary\ shares} \qquad (15)$$

$$PriceEarnings\ ratio = \frac{Market\ price\ of\ Stocks}{Earning\ per\ Share} \qquad (16)$$

$$Earning\ per\ share = \frac{Net\ Income\ to\ Common\ stockholders}{Weighted\ averages\ Shares\ outstanding} \qquad (17)$$

$$Dividend\ yield = \frac{Dividend\ per\ share}{Stock\ price} * 100 \qquad (18)$$

$$1,2A + 1,4B + 3,3C + 0,6D + 1,0E \qquad (19)$$

3   Theoretical part

The first chapter of the thesis is the theoretical part. It will specify the definition of the financial analysis. The goals and methods of the financial analysis will be defined. Thereupon, there were described different ways of financial analysis based on the type of data taken for a comparison. The main financial ratios and indicators are given with specifications of their purpose and structure. Alongside, theoretical part contains literature review of the company background, which is the fast fashion industry.

3.1   The Application of Financial Analysis

Financial analysis is an assessment of the company's financial and economic activities in the past, present and expected future. Its goal is to determine the state of financial health of the company, identify weaknesses, potential sources of problems in its future work and find strengths. Various economic actors, which are interested in obtaining the fullest information about company's activities, rely on financial analysis in evaluation of the financial situation of a firm. Thus, business owners analyze financial reports to increase capital returns, ensure the stability of the company. Lenders and investors analyze financial reports to minimize their risks on loans and deposits. (Lee, 2016)

Financial analysis is a method of assessing and forecasting the financial condition of an enterprise based on its financial statements. It can be performed both by the management staff of the enterprise and by any external analyst, since it is mainly based on public information. Nevertheless, it is customary to distinguish two types of financial analysis: internal and external. (Gibson, 2012)

Internal analysis is carried out by employees of the enterprise. The information base of such analysis is much broader and includes any information circulating within the enterprise and useful for management decisions. Accordingly, the analysis capabilities are expanded.

External financial analysis is carried out by analysts who are outsiders to the enterprise and, therefore, do not have access to the internal information base of the company. External analysis is less detailed and more formalized. (Gibson, 2012)

To ensure the survival of the enterprise in modern conditions, management personnel must be able to assess the financial condition of both their enterprise and its real and

potential counterparties. In order to do the assessment of such type, specialists must have following:

a) a methodology for assessing the financial condition of the enterprise;

b) reliable information sources;

c) qualified personnel able to implement this methodology in practice.

Financial assessment can be performed with varying degrees of detail depending on the purpose of the analysis, available information, software and personnel. (Gibson, 2012)

The basis of the financial analysis should be the financial statements. Additional information, mainly of an operational nature, can be used in the analysis, but it is only a supporting factor.

The main purpose of the financial analysis is to obtain a small number of key and most informative parameters that give an objective and accurate picture of the financial condition of the enterprise, its profits and losses, changes in the structure of assets and liabilities, changes in settlements with debtors and creditors.

As a result of the financial analysis, both the current financial condition of the enterprise and the expected parameters of the financial condition are determined.

The objectives of financial analysis also depend on the subjects of analysis. The goals of financial analysis are achieved through the solution of a certain interrelated set of analytical tasks. The analytical task has to specify the objectives of the analysis taking into account the organizational, informational, technical and methodological capabilities of the analysis. The main factor is ultimately the volume and quality of the information source.

Financial analysis is the process of examining the financial condition and main financial performance of an enterprise in order to identify reserves for further raising its market value. The methodology of a comprehensive financial analysis of the enterprise is a determined essence of the financial analysis and its necessity in the organization. (Palepu, et al., 2013)

3.2   Principle of Financial analysis

There are numbers of methodological recommendations for financial analysis. In the economic literature, the basic principles for the process of financial analysis include:

1)   The principle of *systematicity* involves studying the activities of an economic entity as a system, the compounds of various departments and divisions involved in the production or provision of services. The systemic nature of financial analysis is also

present at the macro level, where the enterprise is seen as part of a larger economic system (region, industry, etc.).

2)   The principle of *scientificity* involves the disclosure of the economic essence of the studied phenomenon, its assessment through all available scientific methods and analysis procedures.

3)   The principle of *complexity* requires a comprehensive study of the object, the study of its elements and their interaction with each other, as well as the influence of various external and internal factors on the object.

4)   The principle of *regularity* involves the selection of a time interval of analysis for each subject of the study, depending on the goals and tasks facing the management of the enterprise. The analysis may be carried out at regular intervals or continuously.

5)   The principle of *specificity* is implemented in the target orientation of the analysis. According to it, the goals, tasks, necessary tools are formulated specifically and precisely, in order to be as descriptive and convenient as possible to fulfill.

6)   The principle of *objectivity* implies the proof of the conclusions from the analysis by fully revealing the causes of changes in the studied objects. In application of this principle, it is very important to minimize any subjectivity when interpreting the received information.

7)   The principle of *continuity* involves adherence to common principles of analytical work, comparability of conclusions drawn from different thematic analyses at different periods of time.

8)   The principle of *efficiency* assumes that the cost of analytical work and the amount of work should be commensurate with the effect that the analysis provides.

9)   The principle of *caution* involves the use of reliable, verified information, since the results of any analytical procedures, regardless of the type of analysis, should be considered as subjective assessments, which cannot serve as an undeniable argument for making a managerial decision.

10)   The *programmatic* principle implies a clear program of analysis to understand the goals and expected results.

11)   The *deployment* principle involves the use of a deductive calculation algorithm with highlighting the most significant points and discarding insignificant ones.

12)	The principle of *estimation of deviations* assumes that any significant deviations from normative, planned or average industry values of indicators and their trends have to be explained and carefully analyzed even when they are positive.

13)	The principle of *adequacy* of analytical tools assumes that the choice of analytical tools in the analysis should be based on the idea of its appropriateness, since the use of complex tools and methods does not guarantee better assessments and conclusions.

14)	The principle of *acceptable accuracy* in calculations assumes that when conducting an analysis, the most valuable part is the identification of trends and patterns, and not obtaining extremely accurate estimates.

15)	The principle of *appropriateness* implies that the process of analysis should end with a synthesis of the results obtained and the formulation of relevant conclusions and recommendations, the number of which should not be large.

The principles form the basis of the analytical work system. Any management decision is preceded by some justification, usually based on the results of specific analytical procedures. The meaning and significance of such procedures, especially in business, go far beyond simple arithmetic actions or the calculation of analytical indicators. Thus, in the process of financial analysis, it is necessary to remember that using the number of existing methods and tools, various results can be obtained, which often contradict each other. In this case, the results of the analytical procedures carried out should not be absolutized, they should not be considered as true arguments justifying the adoption of a management decision, they should be supplemented by various kinds of subjective assessments. (A.I. Korotkevich, 2018)

## 3.3	Information sources of Financial analysis

Conducting financial analysis of the company requires the use of various documents, statistical and financial statements of the business entity, annual reports of managers. Special attention should be paid to the quality and reliability of the information used. The organization of financial analysis in the presence of electronic information resources and automated management systems requires the study of experiences, as well as the opportunities which companies acquire by means of modern information technologies.

A system that automates the collection, preparation and processing of information is only one of the necessary components that determines the success of a business. Experience shows that the most successful organizations in the business world are those

that are able to quickly collect, process, analyze information and make decisions based on it. A growing number of managers understand that an effective automated system is an integrated system that encompasses all interrelated business processes.

The main sources of information for financial analysis are the balance sheet, financial statement and explanatory note. The analysis of the financial results of the organization includes an analysis of absolute indicators, which are profits and losses characterizing the degree of financial well-being of the organization, as well as the calculation of relative indicators impacting profitability. (Bernstein & Wild, 2000)

The key figures for profit analysis are contained in the financial statement. A factor analysis of profit and profitability will require balance sheet information and an explanatory note. In addition, financial results should be analyzed taking into account cash flow data in order to develop concrete measures to improve the company's performance. This is partly due to the fact that current reporting reflects financial results generated by the accrual method rather than the cash method (i.e. income and expenditure are reported in the reporting period in which they occurred, regardless of the actual cash flow associated with them). In addition, part of cash receipts and disposals do not directly affect the financial results of the reporting period, since they are not considered in this period as income and expenses for current activities that affect financial results directly (receipt and return of loans, acquisition of fixed assets, financial investments, etc.). The type of expenses that affect financial results, such as depreciation, cannot be expressed in terms of cash flow in terms of its economic content, so it is advisable to analyze the financial results of the company's activities in close connection with the movement and change of cash flows of the company. (Higson, 2006)

Cash flow analysis identifies and analyses the trends in cash flow and expenditure. The main source of information for the analysis of the general structure of cash flows is the cash flow report, in which cash receipts and payments are presented in the context of current, investment and financial activities. The analysis reveals the type of activity of the organization that provides the largest cash inflow, as well as the types of activities for which cash receipts and disposals have increased or decreased most compared to the previous period. Thus, the analysis of cash flows allows you to establish the sources of income and the directions of expenditure to control the liquidity and solvency of the organization. (Bernstein & Wild, 2000)

When analyzing business activity and performance of a company, it is necessary to assume that different market counterparties can approach their valuation in different ways. The indicators of capital turnover, resource recovery, cost-effectiveness and profitability are among the very conditional, but rather objective indicators of business performance. The analysis determines their level and dynamics. The source for the analysis is also the company's financial statements.

Investment analysis determines the effectiveness of investment activities, which is expressed in the return of investments of the enterprise in its development, as well as in securities and shares of other enterprises. The sources of information for the analysis are the balance sheet, the financial reports, as well as the explanatory data of the balance sheet and other explanatory notes, in particular, sections reflecting amortized property, the movement of funds for financing long-term investments, short-term financial investments, decryption of individual profit and loss items. This type of financial analysis allows you to develop methods for managing investment risks. (Helfert, 2001)

The analysis of the effectiveness of the current business management system is based on an assessment of the achieved indicators of the company's manageability, growth in labor productivity, dynamics of economic potential, the return on the company's management costs, cost efficiency, and the efficiency of its business processes. The analysis uses the accounting and statistical reports on the number, wages and movements of workers.

The main sources of financial analysis are data from operational, financial, economic and statistical accounting, as well as planned (normative) indicators. Along with internal information, it is necessary to analyze data characterizing the working conditions of the organization in the region, industry, and the economy as a whole (Savitskaya, 2014):

- by sources of income: external, received in the market, and internal, received in the company;
- by type: legal, financial, technical, commercial;
- by scale: macroeconomic, sectoral, individual enterprise and its divisions.

In addition, information that can be used for analysis can be classified into four groups:

- sources of financial benefits from the business;
- financial indicators of the business in the dynamics for the retrospective period and for a certain perspective of 1-3 years;

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- non-financial indicators of the business, which are the share of the transaction in the total business volume, the organizational and legal form of the business and its statutory provisions, which is directly related to the liquidity of shares;

- external indicators, which are related to external macroeconomic risk factors. (Savitskaya, 2014).

3.4   Users of Financial analysis

Different types of business analyses and their results are commonly used by a wide variety of stakeholders. Usually, financial accounting and managerial accounting are distinguished in business activities.

Financial accounting is based on accounting information, which, in addition to internal use, is communicated by management to external parties. Whilst management accounting covers all types of accounting information that is measured, processed and transferred for internal use by management. Consequently, the financial analysis is divided into external and intra-economic analysis. (Helfert, 2001)

External financial analysis can be carried out by stakeholders. The basis of this analysis is mainly the official financial statements of the enterprise, both published in print and presented to interested parties in the form of an accounting balance. For example, to assess the stability of a bank, the client reviews the balance sheets of banks, on the basis of which they calculate certain indicators for comparison with stable banks. But, unfortunately, a complete, comprehensive analysis cannot be done due to the insufficiency and limited information provided in the financial and accounting documents.

External analysis includes analysis of absolute and relative indicators of profit, profitability, liquidity of the balance sheet, solvency of the enterprise, efficiency of using borrowed capital, general analysis of the financial condition of the company. In contrast, internal financial analysis is necessary and carried out for the interests of the enterprise itself. It controls the activities of the enterprise, not only financial activities, but also organizational, and outlines further ways to develop production. (Lee, et al., 2016)

Based on the varieties and purposes of the analysis, it is possible to identify the external and internal circle of interested parties in such information. The external circle of individuals usually includes users with direct and indirect financial interests, and internal includes first and foremost the administration.

The external group of interested parties consists of users with the direct financial interest: investors, lenders, suppliers, business partners, buyers and customers. Based on the public financial statements, they draw conclusions about the profitability and liquidity of the company, the company's financial prospects in the future, whether it worth investment, whether the company has money to pay interest and pay off debts in time. (Fridson & Alvarez, 2011)

Users of financial analysis with indirect financial interest consists of government bodies and extra-budgetary funds, tax authorities, investment institutions, commodity and stock exchanges, insurance organizations, firms conducting external audits. Information on the financial activities of enterprises is necessary for this group, in order to monitor compliance of enterprises with obligations to the state, to regulate the amount of paid federal and local taxes, to develop the methods of privatization and corporatization of the enterprise. Based on the results of the financial analysis, the government produces generalized synthetic estimates which allow to judge the situation of not only a single enterprise, but also the industry as whole.

Companies registered in investment funds and stock exchanges must submit special financial reports to them. In addition, users of information with indirect financial interest include auditors and audit firms, financial advisers, lawyers and law firms, the press and news agencies, as well as the public.

Internal users with financial analysis results include the administration of the company. Those are the owners and the employees of the company, who are responsible for the management of the enterprise and the achievement of its goals. The successful performance of the management is based on correct management decisions arising from the financial analysis of the company. (Fridson & Alvarez, 2011)

3.5 Approaches to financial analysis

Different researchers propose different methods of financial analysis. The specifics of the procedural side of the methodology depend on the goals set, as well as the various factors of information, temporary, methodological and technical support. The logic of analytical work implies its organization in the form of a two-module structure:

- quick analysis of financial condition,
- detailed analysis of financial condition.

The purpose of quick analysis is a clear and simple assessment of the financial well-being and dynamics of the development of the business entity. Researcher V.V. Kovalev proposes to calculate various indicators and supplement them with methods based on the experience and qualifications of a specialist. The author believes that quick analysis should be carried out in three stages:

- preparatory stage,
- preliminary review of financial statements,
- economic reading and analysis of reports.

The purpose of the first stage is to decide on the appropriateness of analyzing the financial statements and to make sure that it is ready to read. There is a visual and simple accounting check of reporting according to formal characteristics such as the presence of all necessary forms and applications, determined stumps and signatures, the correctness and clarity of all reporting forms. The system checks the balance sheet currency and all subtotals. (Kovalev, 2019)

The purpose of the second stage is examination of the explanatory note to the balance sheet. This is necessary in order to assess the working conditions in the reporting period, determine trends in the main indicators of activity, as well as qualitative changes in the property and financial position of the business entity.

The third stage is the main one in the quick analysis. Its purpose is a generalized assessment of the economic results and financial condition of the facility. This analysis is carried out with specific details for the benefit of different users.

V.V. Kovalev proposes to conduct the quick analysis of the financial condition according to the methodology mentioned above. The quick analysis may have a conclusion that further in-depth and detailed analysis of the financial results and financial situation is necessary. The purpose is detailed description of the property and financial situation of the business entity, the results of its activities in the expiring reporting period, as well as the potential for the development of the entity. It specifies, complements and expands the individual procedures of quick analysis. (Kovalev, 2019) V.V. Kovalev proposes the following program of in-depth analysis of the financial and economic activities of the enterprise:

1) Preliminary review of the economic and financial situation of the business entity.

- Description of the general orientation of financial and economic activity.
- Identification of reporting weaknesses.

2) Assessment and analysis of economic potential of the entity.

- Property assessment.
- Create an analytical net balance sheet.
- Vertical analysis.
- Horizontal analysis.
- Analysis of qualitative changes in property status.
- Financial assessment.
- Liquidity assessment.
- Assessment of financial sustainability.

3) Evaluation and analysis of financial and economic performance of the business entity.

- Assessment of primary activities.
- Analysis of profitability.
- Situation assessment in securities market.

Characteristics of the key indicators used in the analysis of financial and economic activity will be described in the following parts of the literature review. (Kovalev, 2019)

I would like to continue with the technique of financial analysis offered by I.T. Balabanov in his book "Risk Management". (Balabanov, 2006)

The movement of any inventory item, human and material resources is followed by accrual and expenditure of money, therefore the financial condition of economic entity reflects all parties of production and trade activities. I.T.Balabanov suggests another approach to financial analysis, which follows the scheme below:

- analysis of profitability;
- analysis of financial stability;
- analysis of solvency;
- analysis of capital intensity;
- analysis of level of self-financing;
- analysis of currency self-sufficiency.

The analysis of profitability of economic entity is characterized by absolute and relative measures. The absolute measure of profitability is the sum of profit, or income. The relative indicator is the level of profitability. The level of profitability of business entities associated with the production of products (goods, works, services) is determined by the percentage of profit from the sale of products to the cost of production.

The analysis examines the dynamics of net profit, the level of profitability and the factors that determine them. The enterprise is considered to be financially sustainable if:

- It covers funds invested in assets (fixed assets, working capital) at the expense of own funds. It does not allow unjustified receivables and payables.
- It pays on time for its obligations.

I.T. Balabanov believes that the main financial activity is the correct organization and usage of working capital. The analysis of the financial situation therefore focuses on working capital management. (Balabanov, 2006)

Characteristics of financial sustainability include analysis of:

- Composition and placement of assets of the business entity;
- Trends and patterns of sources of financial resources;
- Availability of own working capital;
- Accounts payable;
- Structure of working capital;
- Receivables;
- Solvency.

Solvency of a business entity means that it has the prerequisites for obtaining a loan and the ability to repay it on time. The solvency of the borrower is characterized by its accuracy in calculating previously received loans, its current financial condition and prospects for change, and the ability to mobilize funds from various sources if necessary.

A number of indicators are used in credit analysis. The most important of them are the rate of return on invested capital and liquidity. The rate of return on invested capital is determined by the ratio of profit to the total amount of liability on the balance sheet. Liquidity of a business entity is its ability to quickly repay its debt. It is determined by the ratio of debt to liquidity. Liquidity indicators will be discussed in detail further in this work. (Balabanov, 2006)

Capital investment should be effective. Capital efficiency refers to the amount of profit attributable to 1 unit of invested capital. Capital efficiency is a complex concept that includes the use of working capital, fixed assets and intangible assets. Therefore, the analysis of capital efficiency is carried out in separate parts:

1) The efficiency of the use of working capital is characterized, first of all, by its turnover. Turnover of working capital is calculated with a duration of turnover in days or the number of turnover during the reporting period.

2) Efficiency of capital use in general. Capital as a whole is the amount of working capital, fixed assets and intangible assets. Capital efficiency is best measured by its profitability. The level of return on capital is measured by the percentage of book profit to capital.

Self-financing means financing from own sources: depreciation and profit. The effectiveness of self-financing and its level depend on the proportion of its own sources. However, the economic entity cannot always fully provide itself with its own financial resources and therefore it widely uses borrowed and raised funds as an element that complements self-financing.

The principle of currency self-sufficiency is to exceed the income of the currency over its expenses. Compliance with this principle means that the economic entity does not "eat" its monetary fund, but constantly accumulates it. (Balabanov, 2006)

3.5.1 Fundamental (qualitative) analysis

Fundamental analysis is a qualitative analysis of the company's reporting documents aimed to determine the real value (intrinsic value) of its assets and to predict its income in the future. Another practical application of fundamental analysis is to identify undervalued companies. By comparing companies in the same industry, it is possible to identify devalued and revalued assets.

An in-depth study of the current state of the company, its development prospects, materials published by the company, profit and loss accounting reports are carried out as part of the fundamental analysis. Based on the results of the analysis, the content of the investment portfolio is determined. It selects shares of companies characterized by stable financial and economic indicators and high potential for further development. A number of macroeconomic indicators are also taken into account, such as inflation, the interest rate of the Central Bank, and the level of business activity. At the same time, the fundamentalist analyst ignores the behavior of market stock prices. Therefore, fundamental analysis perfectly complements technical analysis based on the study of market price dynamics and trading volume. The joint application of both methods provides a holistic view of the market situation and most accurately predicts the direction of changes in stock prices. (Iskhakova & Mimar, 2016)

3.5.1.1 Selection of prospective shares

One of the most important tasks facing a participant in the stock market is the division of all issuing companies into two groups: "fundamentally strong" and "fundamentally weak." Classical fundamental analysis does not give an exact answer to this question. Each investor independently forms a list of the most important criteria based on his/her own investment preferences. For example, the American fund Idex Great Companies of America is focused on acquiring shares of enterprises founded at least 50 years ago.

First of all, it is necessary to find out what this company is doing, and what type of activity brings it the main income. According to the great investor Warren Buffett, financial success in the stock market is directly proportional to the understanding of the internal principles of companies. "Invest in your area of expertise," he says. The first criterion stems from the statement: the clarity of the business. This is the most subjective criterion, but it plays a crucial role in choosing objects for investment. It is unlikely that the acquisition of shares of companies doing business in unfamiliar areas of activity will bring profit. (Dummies, 2016)

Three levels of fundamental analysis

Fundamental analysis is carried out at three levels:

1) Analysis of the state of the economy as a whole

2) Industry Analysis

3) Company Analysis

3.5.1.2 The stock market economy as a whole

At this level, the influence of economic and political factors on the development of the stock market is considered. Fundamental analysis allows us to find out how the general situation is favorable for investment. Macroeconomic volatility is critical, as it can affect expected income and risk even in a well-balanced portfolio. (Dummies, 2016)

Particularly important indicators are:

- The base interest rate in the country and its change. A rate increase negatively affects the price of shares. On the contrary, a decrease supports their growth. This is mainly due to the high degree of dependence of companies on loans.

- GDP and GNP. The growth of these indicators means an increase in the volume of production of companies, which is reflected in the performance of the stock market.

- Oil prices. They are especially important for evaluating companies somehow associated with the fuel sector.

- Political system, ruling party. For example, the arrival of Democratic power in the United States negatively affected the state of the American stock market. Since Democrats are believed to be negative about large companies and tend to increase the tax burden.

- Level of economic activity. It is most clearly reflected in the ISM business activity indices in the services and production sector. The growth of indicators characterizes the rise in the stock market.

3.5.1.3 Industry analysis

At this stage, the most promising industries are identified. The dynamics of the development of industries are reflected in sectoral stock indices. The most famous of them can be called DJIA (Dow Jones Industrial Average), reflecting the development dynamics of the industrial sector, DJTA (Dow Jones Transportation Average) - the transport sector and DJUA (Dow Jones Utilities Average) - the utility sector. There are also a number of NASDAQ. Nasdaq indices Financial-100 determined based on about a hundred shares of financial companies. Nasdaq Industrial, Nasdaq Transportation, Nasdaq Bank, Nasdaq Telecommunications, Nasdaq Insurance, Nasdaq Computer, Nasdaq Other Finance, Nasdaq Biotechnology characterize exchange rate fluctuations of shares of industrial and transport companies, banks, telecommunications, insurance and computer companies, financial non-banking institutions, companies working with biotechnology. (Iskhakova & Mimar, 2016)

In the course of an industry analysis, a potential investor chooses the industry of greatest interest to him. (Korotkevich, et al., 2018) All industries are conditionally divided into the following main groups:

1) Growing industries. They are characterized by a constant and fast increase in sales and profits compared to other industries. Companies of such industries are called growth companies, and their shares are called growth stocks.

2) Stable industries. They are distinguished by the sustainability of their development; they are less affected than others by the overall economy.

The following general categories of shares of stable industries are distinguished:

- Blue Chips are stocks with the best investment properties. They pay dividends even during unfavorable economic conditions; they have a monopoly rule in the market, financial power and effective management.

- Defensive stocks are shares of companies that are relatively resilient to bad conditions; they more or less steadily profit and pay dividends.

- Profitable stock are shares on which generous dividends are paid. The amplitude of price fluctuations and the potential for capital growth of profitable stocks are insignificant.

3) Cyclical industries characterized by a special sensitivity to the economy phase (recovery, decline, crisis). Such industries include industries that produce means of production, as well as durable goods. In cyclical industries, profitability and risk of stock investment depend significantly on the phase of the business cycle.

4) Fading industries, which use obsolete technology or produce obsolete products.

5) Speculative industries, which pose a particular risk to investors due to lack of reliable information.

3.5.1.4 Status of individual firms and companies

Having chosen the industry that seems most attractive and promising, it is important to correctly determine the company itself, whose shares are most profitable to purchase. (White, et al., 2002) To do this, you need to analyze the following performance indicators of companies:

- Annual and quarterly reports on the company's activities. The annual report is the main document that fully reflects the company's activities. It is necessary to take into account the dynamics of indicators and their essence, rather than published profits.

- Materials that the company publishes about itself.

- Information reported in public speeches of the company management.

- Launch of new products.

- Mergers and acquisitions.

- Increase/decrease in dividend payments.

- Litigation involving the company.
- Changes in management.
- Senior management's ownership of stocks.

Company analysis is the most complex and time-consuming. At this stage, the financial and economic situation of the company over the past few years is studied (usually 3-5 years). The efficiency of company's management and the prospects for its development are predicted. (White, et al., 2002)

3.5.2 Technical (quantitative) analysis

Technical analysis examines market conditions in the past with the help of graphs of price dynamics, volumes, moving averages and statistics of various changes. Whilst fundamental analysis examines the company's financial statements to determine its value.

Technical analysis can be presented as a huge graph, which reflects years of market information, when fundamental analysis can be focus on individual companies.

The two main schools of market analysis have long competed with each other. Chartists believe that it makes no sense to look at the published reports of the company, because much more can be learned from the quotation of its shares. At the same time, critics of technical analysis say that the results are influenced by analytic bias, so they can be interpreted too freely. (Yioryalis, 2004)

Technical analysis has only recently been more widely accepted. Investment banks still rely on fundamental analysis, but often do not ignore the opinion of technical analysts.

3.5.2.1 Philosophical basis of technical analysis

The technical analysis is based on the following basic postulates arising from the Dow theory (Rhea, 1993):

1. The market takes everything into account. In other words, the price is a consequence and an exhaustive reflection of all the driving forces of the market. Any factor affecting the price (economic, political or psychological) has already been taken into account by the market and it is included in the price. Thus, everything that affects the price will be reflected by this price.

2. The changes in the market are subordinate to trends. Trend is one of the fundamental concepts in technical analysis. Market life consists of alternating periods of growth and falling prices, so that within each period there is a development of the

dominant trend, which exists until the market begins to develop in the opposite direction. The challenge is to identify these trends in the early stages of their development and trade according to their direction.

3. History repeats itself. The fact, that certain configurations on price charts have the property of repeating themselves stably and repeatedly in different markets and on different scales of time, is a consequence of the objective laws of physics, economics and psychology.

All methods for predicting the future are based on the above-mentioned rules. They were in force in the past are in force now, and most probably, they will be also applied in the future.

3.5.3   Comparison of Technical and Fundamental analysis

If the technical analysis is mainly concerned with market dynamics, the subject of fundamental analysis is the economic forces of supply and demand, which cause price fluctuations.

In fact, technical and fundamental analysis in the approach to predicting market dynamics are trying to solve the same problem. They determine in which direction prices will move. However, they look at this problem from different perspectives. While a fundamental analyst is trying to understand the reasons for the market movement, the technical analyst is only interested in the fact of this movement. Technical analysts need to know if there is a market movement, and it is not so important what exactly caused it. Fundamental analyst will try to find out why this happened. (Yioryalis, 2004)

The market price is ahead of all known fundamental data. In other words, market price is a leading indicator of fundamental data. While the market has already taken into account all the known economic factors, prices are beginning to respond to some completely new, still unknown factors.

The most significant periods of rising or falling prices in history began in an environment where nothing, in terms of fundamentals, foreshadowed any change. When these changes became clear to fundamental analysts, the new trend was already developing in full force. (Yioryalis, 2004)

3.6   Methods and indicators of Financial analysis

Financial analysis is a process of researching the financial condition and main financial results of the enterprise with the aim of identifying reserves for increasing its market value and ensuring further effective development.

The results of the financial analysis are the basis for making management decisions and developing a strategy for the further development of the enterprise. Therefore, financial analysis is an integral part of financial management, its most important component. (Gibson, 2012)

There are six main methods of financial analysis:

1. Horizontal (time) analysis is comparison of each reporting item with the previous period. Horizontal analysis forms:

    1) comparison of financial indicators of the reporting period with indicators of the previous period (for example, with indicators of the previous decade, month, quarter);

    2) comparison of financial indicators of the reporting period with indicators of the same period last year (for example, the second quarter of the reporting year with similar figures for the second quarter of the previous year);

    3) comparison of financial indicators for a number of previous periods. The purpose of such analysis is to identify the trend of individual indicators characterizing the financial performance of the enterprise. The results of such an analysis are usually graphically presented in the form of linear graphs or a bar diagram of the change in the indicator dynamics.

2. Vertical (structural) analysis is an identification of the specific weight of individual articles in the final indicator, taken as 100%. The results of the vertical analysis can be graphically depicted in the form of a column or sector diagram of the indicator's structure. The most common forms of structural (vertical) analysis are:

    1) Structural Asset Analysis. In the process of this analysis, the ratio of current and non-current assets, the composition of the used current assets, the composition of the used non-current assets, the composition of the enterprise's assets according to the degree of their liquidity, the composition of the investment portfolio and other indicators are determined.

    2) Structural Capital Analysis. In the process of this analysis, the share of equity and borrowed capital, the composition of the used equity, the

composition of the used borrowed capital by types, the composition of the used borrowed capital by maturity of obligations are determined.

3) Structural analysis of cash flows. In the process of this analysis, cash flows are allocated as part of the total cash flow for operational (production) activities, for financial and investment activities. Each of these types of cash flow can be deeply structured by its individual components

3. Trend analysis compares each reporting position with a number of prior periods. It defines a trend, which is the main trend of the indicator dynamics cleared from random influences and individual characteristics of individual periods. Using the trend, possible values of indicators are formed in the future, and therefore, a forecast analysis is carried out. (Korotkevich, et al., 2018)

4. Analysis of relative indicators (coefficients) is a calculation of relationships between individual reporting items, determination of relationships between indicators. Analysis of financial ratios is based on the calculation of the ratio of various absolute indicators. The analysis identifies various relative indicators that characterize different aspects of financial activity. The most common aspects of this analysis are financial sustainability, solvency, asset turnover and profitability. (Tracy, 2012)

5. Comparative (spatial) analysis is an analysis of reporting indicators of subsidiaries, structural divisions. At the same time, it could be a comparative analysis with indicators of competitors, industry averages, etc. The comparative financial analysis is based on comparing the values of individual groups of similar financial indicators. During this analysis, the dimensions of the absolute and relative deviations of the compared indicators are calculated. The most common forms of comparative analysis are:

1) Comparative analysis of the financial indicators of the enterprise and the average industry indicators. In the course of this analysis, the degree of deviation of the main financial results of the enterprise from the mid-industry is determined in order to further improve its efficiency.

2) Comparative analysis of the financial performance of the enterprise and its competitors. In the course of this analysis, the weaknesses of the enterprise's activities are identified in order to develop measures to increase its competitive position.

3) Comparative analysis of financial indicators of individual structural units and subdivisions of this enterprise. Such an analysis is carried out in the context of the economic responsibility centers formed at the enterprise in order to compare the effectiveness of their financial activities.

4) Comparative analysis of reporting and planned (normative) financial indicators. During this analysis, the degree of deviation of the reporting indicators from the planned (normative) indicators is determined, the reasons for these deviations are determined and the corresponding adjustments are made to the subsequent financial activities. (Lee, et al., 2016)

6. Factor analysis is an analysis of the effect of individual factors (causes) on the resulting indicator. Moreover, factor analysis can be both direct, when the resulting indicator is divided into components, and inverse, when its individual elements are combined into a common indicator. (Savitskaya, 2014)

3.7 RATIO Indicators

Financial ratios are used to assess the financial situation and performance of enterprises. Financial ratio is the ratio of one accounting indicator to another. The analysis of the various coefficients can give a qualified analyst a more complete idea of the financial condition of the firm than that, which he could obtain from the analysis of some characteristics taken separately. (Tracy, 2012)

Financial analysis uses more than 200 coefficients. All these ratios are characterized by four main indicators of the financial performance of any organization:

- liquidity;
- profitability;
- asset turnover;
- market value.

The factors are calculated depending on the set task of financial analysis and the range of users for whom the company's financial activity information is intended.

The main indicators characterizing the financial condition of the enterprise are solvency and liquidity ratios. The concept of solvency is broader than the concept of liquidity. Thus, capacity to pay is understood as the ability of a company to completely fulfill its payment obligations, as well as the availability of money necessary and sufficient

to fulfill these obligations. The term liquidity means ease of realization, sales, transformations of material values into money. (Tracy, 2012)

The main way to determine the solvency and liquidity of the company is a coefficient analysis. The financial factor is a relative measure calculated as the ratio of individual balance sheet items and their combinations. In the economic literature, coefficient financial analysis generally refers to the study and analysis of financial reporting through a set of financial coefficients that characterize the financial situation of the organization. The purpose of the coefficient analysis is to describe the company by several basic indicators that allow you to judge its financial condition.

3.7.1 Liquidity ratios

Liquidity is the ability of a firm to quickly respond to unexpected financial problems and opportunities: increase assets while sales grow and repay short-term debts by turning assets into cash. Therefore, it provides information on company's solvency. Low liquidity is frequently a sing preceding financial distress and bankruptcy. Liquidity ratios might give prompt and early insight into firm's cash flow problems. The most common liquidity ratios are current ratio, cash ratio and quick ratio, which is also called acid-test. (Gibson, 2012)

3.7.1.1 Cash ratio

Cash ratio shows what share of short-term debt can be covered by cash and cash equivalents in the form of market securities and deposits. (Bernstein & Wild, 2000)
It is calculated by the formula:

$$Cash\ ratio = \frac{Cash + Shortterm\ Investment}{Current\ Liabilities} \qquad (1)$$

Recommended values are 0.5 – 1,0

3.7.1.2 Quick ratio

Quick ratio (acid-test) shows the relation of the most liquid part of working capital (cash, receivables, short-term financial investments) to short-term liabilities. Such an assessment of solvency is important for lenders of an entity. It can be used in the company's own interests as well. Its validity depends heavily on the quality of the data involved in the calculation of the coefficient. (Fridson & Alvarez, 2011)

It is calculated by the formula:

$$Quick\ ratio = \frac{Current\ Asset - Inventories}{Current\ Liabilities} \qquad (2)$$

Recommended values: 0.7 - 1

3.7.1.3 Current Ratio

It shows whether the enterprise has enough funds that can be used to pay off short-term obligations. According to international practice, the liquidity ratio should be between one and two. The value of the coefficient below the norm indicates the probable difficulties in the organization's repayment of its current obligations. However, to complete the picture, you need to look at the cash flow from the organization's operational activities. Often, a low ratio is justified by a powerful cash flow (for example, in fast food chains, retail). (Fridson & Alvarez, 2011)

High current liquidity ratio is also not desirable, as it may reflect insufficient use of current assets or short-term financing. In any case, creditors prefer to see a higher coefficient value as a sign of a stable position of the company.

It is calculated by the formulas:

$$Current\ ratio = \frac{Current\ Assets}{Current\ Liabilities} \qquad (3)$$

$$Current\ ratio = \frac{Cash + Account\ Receivables + Shortterm\ Investment}{Current\ Liabilities} \qquad (4)$$

Recommended values: 1,5 – 2,5

One of the main tasks of analyzing the indicators of liquidity and solvency is to assess the degree of proximity of the organization to bankruptcy. Liquidity indicators are not related to the assessment of the company's growth potential, they reflect mainly the momentary situation. If the company works for the future, the significance of liquidity indicators drops significantly. Accordingly, it is recommended to begin an assessment of the financial condition of the company with an analysis of its solvency. (Balabanov, 2006)

3.7.2 Profitability Ratios

Profitability is a relative measure of economic efficiency. The profitability of the enterprise comprehensively reflects the degree of efficiency in the use of material, labor and monetary and other resources. (Tracy, 2012)

In general, product profitability implies that the production and sale of this product brings profit to the enterprise. The level of profitability is determined using relative indicators. Profitability indicators can be conditionally divided into three groups:

- profitability of sales;
- profitability of equity;
- profitability of assets.

3.7.2.1 Return on Sales

Profitability of sales is a profitability ratio that shows the share of profit in each earned unit. It is usually calculated as the ratio of net profit (profit after tax) for a certain period to the volume of sales expressed in cash for the same period. (Fridson & Alvarez, 2011)

Return on Sales (ROS), also known as Net Profit margin is calculated according to the formula:

$$ROS = \frac{Net\ Income}{Net\ Sales} \qquad (5)$$

Profitability of sales is an indicator of the company's pricing policy and its ability to control costs. Differences in competitive strategies and product lines cause a wide variety of return on sales values in different companies. It is often used to evaluate the operational efficiency of companies. (Gibson, 2012)

In addition to the above calculation, there are other variations in the calculation of the profitability measure of sales, but only the profit/loss data of the organization are used to calculate all of them (i.e. Income statement).

3.7.2.2 Return on assets

Unlike the measures of profitability of sales, the profitability of assets is considered as the ratio of profit to the average value of the enterprise's assets. Profitability of assets is an indicator of profitability and efficiency of the company, cleared from the influence of

the volume of borrowed funds. Return on assets (ROA) is a relative indicator of performance. It shows the ability of a company's assets to generate profit. The higher the ROA number, the better, due to the fact that the company is earning more money on less investment. (Fridson & Alvarez, 2011)

The most frequently used formula of ROA includes EBIT (Earnings before interest and tax):

$$ROA = \frac{EBIT}{Total\ Assets} \qquad (6)$$

3.7.2.3 Return on equity

Return on equity (ROE) is net profit compared to the organization's equity. This is the most important financial indicator of return for any investor, business owner. It shows how effectively the capital invested in the business was used. Unlike the similar indicator ROA, this indicator characterizes the efficiency of using not all the capital (or assets) of the organization, but only the part of it, which belongs to the owners of the enterprise. It shows the return on shareholder investments in the enterprise. ROE can be expressed by the formula:

$$ROE = \frac{Net\ Income}{Stockholders\ Equity} \qquad (7)$$

The calculation of return on equity only makes sense if the organization has equity (i.e. positive net assets). Otherwise, the calculation yields a negative value that is not suitable for analysis. (Tracy, 2012)

The required level of profitability is achieved through organizational, technical and economic measures. To increase profitability means to get a greater financial result with lower costs.

3.7.3   Activity Ratios

Business activity ratios (Turnover ratios) is a group of coefficients showing the intensity of the use of assets or liabilities. The main turnover factors are:
- Asset turnover ratio.

- Inventory turnover ratio.

- Receivables turnover ratio.

- Turnover of Accounts payable.

- Payable turnover period.

Relative indicators of business activity characterize the efficiency of using the resources of the organization. The average value of the indicators is defined as the average chronological value for a certain period according to the number of available data. (White, et al., 2002)

All factors are expressed in times, and the duration of the turnover is expressed in days. These indicators are very important for the organization. Firstly, the size of the annual turnover depends on the rate of turnover of funds. Secondly, the relative cost of production (circulation) is associated with the size of the turnover, therefore, the faster the turnover, the less costs are incurred for each turnover. The financial situation of the organization, its solvency depends on how quickly the funds invested in assets turn into real money.

3.7.3.1 Asset turnover ratio

The turnover ratio of assets reflects the degree of turnover of all assets held by the organization on a certain date and is calculated as the ratio of sales revenue to the average value of the organization's assets over the period. (White, et al., 2002) The turnover of funds invested in the property of the organization can be assessed by:

$$Asset\ Turnover\ ratio = \frac{Sales}{Total\ Assets} \tag{8}$$

3.7.3.2 Inventory turnover ratio

Inventory Turnover ratio is a financial indicator calculated as the ratio of the cost of goods sold to the average annual inventory. (Fridson & Alvarez, 2011) The higher the turnover of the company's inventory, the more efficient production is and the less the need for working capital. The formula is as follows:

$$Inventory\ Turnover\ ratio = \frac{Cost\ of\ Goods\ sold}{Average\ Inventory} \qquad (9)$$

3.7.3.3 Receivables turnover ratio

The ratio shows the turnover rate of receivables, measures the repayment rate of receivables of the organization, how quickly the company receives payment for sold goods (works, services) from its buyers:

$$Receivables\ Turnover\ ratio = \frac{Revenue}{Account\ Receivables} \qquad (10)$$

When analyzing business activity, special attention should be paid to the turnover of receivables and payables, since these values are largely interconnected. (Fridson & Alvarez, 2011)

3.7.3.4 Accounts Payable Turnover

This is an indicator of the rate at which an enterprise repays its debt to suppliers and contractors. The accounts payable turnover ratio shows how many times (usually in a year) an enterprise pays the average amount of its accounts payable. (Fridson & Alvarez, 2011) The ratio shows an increase or decrease in the commercial credit provided to the enterprise:

$$Accounts\ Payables\ Turnover = \frac{Purchases}{Accounts\ payable} \qquad (11)$$

3.7.3.5 Payable turnover period

Payables turnover period is payables turnover in days. (Higson, 2006) This indicator reflects the average repayment period of the company's debts with the exception of obligations to banks and other loans.

$$Payable\ Turnover\ period = \frac{Accounts\ Payable\ Turnover}{Revenue/365day} \qquad (12)$$

3.7.3.6 External and internal factors affecting turnover rates

When calculating turnover indicators, it is important to consider that various external and internal factors affect the duration of the funds in circulation. (Savitskaya, 2014)

External factors include:

- industry affiliation;
- the scope of the organization;
- the scale of the organization's activities;
- the impact of inflationary processes;
- the nature of business relations with partners.

Internal factors include:

- the effectiveness of the asset management strategy;
- the price policy of the organization;
- Inventory valuation methodology.

Accelerating the turnover of working capital reduces the need for capital: less inventory is required, which leads to a decrease in the level of storage costs and ultimately contributes to increased profitability and improved financial condition of the organization. On contrary, a slowdown in turnover leads to an increase in working capital and additional costs, therefore, to a deterioration in the financial condition of the organization. (Savitskaya, 2014)

Nevertheless, the main approach to estimating turnover ratios is as follows: the shorter the turnover period, the more efficient the business activity of the enterprise.

3.7.4 Debt Ratio

Debt ratios are the coefficients of financial dependence.

Debt ratio characterizes the ratio of the organization's borrowed capital to its assets. This coefficient refers to the group of indicators describing the structure of the organization's capital. (White, et al., 2002)

$$Debt\ ratio = \frac{Total\ Liabilities}{Total\ Assets} \qquad (13)$$

The optimal value of the coefficient of financial dependence is determined as normal up to 0.6-0.7. The optimal ratio is 0.5. A ratio below the norm indicates an organization's too cautious approach to borrowed capital and missed opportunities to increase return on

equity through the use of financial leverage effect. A ratio above the norm may indicate a strong dependence of the organization on creditors.

3.7.4.1 Equity ratio

The equity concentration ratio shows the share of the assets of the organization that are covered by their own sources. The remaining share of assets is covered by borrowed funds. (White, et al., 2002)

$$Equity\ ratio = \frac{Equity}{Total\ Assets} \tag{14}$$

Investors and lending banks pay attention to the value of this coefficient. The higher the coefficient, the more likely the organization will pay off debts at its own expense. The higher the figure, the higher the financial independence of the enterprise.

3.7.5   Market value ratios

The main goal of financial management is to maximize the market value of the enterprise, that is, the welfare of its owners. Therefore, regardless of the form of organization of the business, assessing its effectiveness in terms of current, as well as potential owners or shareholders and other categories of investors is of the utmost importance. (Fridson & Alvarez, 2011)

The last group of ratios is related to the market value of shares. Often it is useful for a firm and potential investor to study financial indicators combining accounting articles and data reflecting the nature of the market situation.

3.7.5.1 Book value

The book value of a share is a key criterion for assessing the performance of an enterprise. The ratio itself is important as much as the dynamics of its changes for managers, investors and partners. (White, et al., 2002)

$$Book\ value = \frac{Equity}{Number\ of\ ordinary\ shares} \tag{15}$$

Although the Book value is considered a useful and important indicator, often its role is limited only to the function of an indicator. The book value of a share may differ

significantly from its nominal value. This is not quite a constant value and it changes year by year. It reflects the amount of capital that falls on one ordinary share. Nevertheless, it is advisable to compare the book value of equity with the market value established in capital markets.

3.7.5.2 Price-Earnings ratio

The Price-Earnings ratio shows how much investors are willing to pay per unit of earnings. This is perhaps the most popular tool for investors to evaluate a firm in capital markets:

$$PriceEarnings\ ratio = \frac{Market\ price\ of\ Stocks}{Earning\ per\ Share} \qquad (16)$$

The relatively high level of the ratio may indicate that investors hope for a significant increase in dividends in the future or the degree of shareholder risk is low, so investors receive relatively small income, or the company expects significant (above average) growth in the future, so it pays most of its income to shareholders. (White, et al., 2002)

3.7.5.3 Earnings per Share

Earnings per share is the source of key information about the financial condition of the company. It can be argued that the EPS ratio of the analyzed firm reflects the results and successes of its competitors.

$$Earning\ per\ share = \frac{Net\ Income\ to\ Common\ stockholders}{Weighted\ averages\ Shares\ outstanding} \qquad (17)$$

This indicator reflects the short-term perspective. It is very sensitive to market conditions. The additional issue of shares without a significant increase in net income leads to a decrease in the rate of profit per share and therefore reduces their attractiveness. It does not make sense to compare the value of this indicator in various enterprises. (White, et al., 2002)

3.7.5.4 Dividend Yield

Dividend is cash flow moving from the firm to the shareholder, this is one of the key points in the valuation of shares. A firm's decision on the amount of dividends is often

related to other financial and investment decisions. Some firms pay small dividends because their management is betting on further development and deliberately trying to save funds to finance the planned expansion. Dividend policy is usually a compromise between withholding profits and paying cash in combination with issuing new shares.

Dividend yield is the ratio of dividends paid for the year to the share price.

$$Dividend\ yield = \frac{Dividend\ per\ share}{Stock\ price} * 100 \tag{18}$$

The dividend yield can be expressed as an annual percentage or as the ratio of the dividend payment to the current price of the share. (White, et al., 2002)

3.8   Altman Z-score

Altman Z-score model is a financial model developed by the American economist Edward I. Altman, designed to give a forecast of the likelihood of bankruptcy of the enterprise. (Institute, n.d.)

Altman used the sample of 66 American companies to build his model during the period 1946-1965. 33 companies went bankrupt during this period, and 33 remained financially stable. He identified only five ratios, in his opinion, most fully reflecting the activities of the enterprise. The economist applied tools of multiple discriminant analysis to determine the weight values of coefficients in the integral model. As a result, he received a statistical classification model to determine the class of the enterprise. (Faulkenberry, 2020)

Altman Z-score formula is based on a combination of 4-5 key financial factors that characterize the financial position and results of the enterprise. Initially, the 4-factor formula was proposed by Altman in the 60s of the last century. Later, the author proposed variations of this formula taking into account the industry characteristics of organizations.

Z-scores for companies with publicly traded shares is calculated according to the five-factor model as follows:

$$1,2A+1,4B+3,3C+0,6D+1,0E \tag{19}$$

- A is Working Capital/Assets;
- B is Retained Earnings/Assets;

- C is EBIT/Assets;
- D is Equity/Liabilities;
- E is Revenue/Assets

3.8.1.1 Validity of the indicator

If Z-score is above 2.99, the company is in the "green" zone of financial stability.

If Z-score lays between the values 1.81-2.99, the company is in "gray" zone of uncertain results.

If Z-score is below 1.81, the company is in "red" zone of high risk of bankruptcy. (Institute, 2020)

3.8.1.2 Evaluation of the accuracy

The test period 1969-1975: model verification on 86 enterprises gave accuracy of 82% in predicting bankruptcy and 75% in forecasting financial viability.

The test period 1997-1999: model verification on 120 bankrupt enterprises and 120 non-bankrupt enterprises gave an accuracy of 94% in forecasting bankruptcy and 84% in forecasting the financial stability of the enterprise.

The advantage of the Altman's model is its simplicity and the objectivity in the choice of indicators. Another advantage is determining the financial health of the firm to creditors and potential customers. The main disadvantage is that they get only one specific indicator, which does not describe the origins of the problems, therefore the issues stay unsolved. (Kittur, 2019)

3.9   DuPont Analysis

The DuPont System of Analysis is a method of financial analysis through the assessment of key factors that determine the profitability of an enterprise. This method was first used by DuPont Corporation in the 1920s. It is a factor analysis, which means that it identifies the main factors affecting the efficiency of the enterprise. (Berghoff & Kustner, 2017)

The purpose of DuPont analysis conducted by the company is to find ways to maximize the profitability of invested capital for owners and shareholders. The profitability of the enterprise and the increase in its value for shareholders is reflected by profitability ratios. Increasing enterprise profitability becomes a key task for all levels of management: strategic, tactical and operational. (myaccountingcourse.com, 2020)

DuPont explosives salesman Donaldson Brown has proposed a simple way to manage profitability by decomposing the profitability factor into factors that reflect different aspects of the enterprise. The DuPont formula is the calculation of a key indicator of performance, Return on Equity (ROE), through three conceptual components:

- profitability of sales (operational efficiency);
- turnover of assets (efficiency of use of all assets);
- financial leverage (credit leverage, equity/leverage ratio).

3.9.1 Advantages and disadvantages of the DuPont model

The main advantage of the model is its easy process of calculation and analysis. This led to the fact that this model was dominant in the financial analysis of US companies till the 1970s. The identified factors that determine the profitability of the company for shareholders are quite easily associated with the operational plans of the enterprise. The main disadvantage of the model is the fact that accounting is not an absolutely reliable source of information about the activities of the firm. The Dupont model and its modifications in three- and five-factor formulas allow the company to quickly assess the degree of influence of various factors on the formation of the key indicator ROE in assessing the value of the company, and its attractiveness to shareholders. Consequently, in cases where the organization has an unsatisfactory return on equity, the DuPont analysis helps to identify which of the factors led to this result. (Berghoff & Kustner, 2017)

3.10 Industry overview

This part contains information about the fashion industry and its characteristics. It presents the background research on the emergence of fast fashion industry, where Inditex operates.

3.10.1 Changes in fashion

It would be important to start with the trends in fashion which fuel its existence. The trends are the results of changes in the society and environment. The trends are followed by all the actors of the fashion industry. Those could be famous fashion houses, high-end luxury brands or a small entrepreneur. They use the trend books, which are composed yearly by special agencies, which summarize the data on worldwide events. The trend books provide overview of possible future trends. Fast fashion is known for a quick

adjustment to all the possible trends, which defines the stores assortment on a monthly or weekly basis.

A change has two dimensions in the field of fashion standards and trends: innovative and cyclical. The most common changes are innovative changes.

The process of fashion innovation, which is the process of introducing and approving an innovation, consists in replacing one standard and object of fashion. That is when it the items become "old-fashioned," "out of fashion". Sometimes, innovation takes place only in the standard, while the object remains the same. An example is another way to wear a hat of the same style. In other cases, the standards remains the same, but the object changes. This is the most obvious and common kind of innovation. For example, changing narrow trousers to wide, short skirts to long. There can be also simultaneous innovation in standards and objects. At last, the fashion innovation may be abandoning an object when it does not comply with fashion values of the time, for example, headgear, fan, etc. (Keller, 2005)

Three ways of implementing fashion innovation and, accordingly, three types of it can be distinguished. It might be carried out by updating one's own tradition in a certain culture or field of culture. This type is designated as innovation through tradition. Due to their temporal remoteness, actualized traditional forms can denote the value of modernity, in other words, they can be perceived as new and innovative with various positive associations. (Knošková & Garasová, 2019)

The effect of the degree of temporal distance or proximity of an object on its perception and assessment can be illustrated by the following indicative scheme of the English researcher of costume history James Laver. He took an example of a suite. And classified that the same suit will be:

- Obscene - 10 years before it is in fashion;
- Indecent - 5 years before it is in fashion;
- Extravagant - 1 year before it is in fashion;
- Graceful – while it is in fashion;
- Tasteless – 1 year after it is out of fashion;
- Disgusting - 10 years after it is out of fashion;
- Funny - 30 years after it is out of fashion;
- Bizarre - 50 years after it is out of fashion;
- Charming - 70 years after it is out of fashion;

- Romantic - 100 years after it is out of fashion;
- Beautiful - 150 years after it is out of fashion;

Another way of fashionable innovation is borrowing from other cultures or from other areas of culture, for example, borrowing style features in clothing from Greek architecture. This type of innovation occupies an important place in changes in standards and objects of fashion due to the important role of universality in the attributive values of fashion. (Daley & Fairhurst, 2018)

Obviously, both of these types of innovations are innovations only in a certain socio-cultural context; "new" in them is new for specific sociums and cultures at a given time in relation to certain cultural patterns. Only the third method of fashion innovation is invention. The introduction of elements which are truly new in history or new combinations of old elements in the field of standards and objects of fashion. This type of innovation is a very rare phenomenon in the fashion industry. Firstly, inventions in themselves in various fields of culture do not occur often. Secondly, they are not always endowed with fashion values. In other words, not every innovation becomes fashionable. Although, various kinds of inventions, like scientific or technical discoveries, the creation of new materials, constitute a powerful factor in fashion innovations. Even scientific discoveries in the field of ancient cultures can stimulate fashionable innovations. The example could be the case of the famous archaeological excavations of the Egyptian pharaoh Tutankhamun's tomb in the 1920s, significantly influenced fashionable innovations in clothing, jewelry, interior in various European countries. (Daley & Fairhurst, 2018)

3.10.2 Fast fashion

Over the past 3 years, the volume of fast fashion market has grown by 21%, significantly ahead of the luxury segment. According to Hitwise, in the first half of 2019, 66% of online sales of the industry were in the fast fashion segment.

"Fast fashion" is a term used by fashion retailers to refer to a quick upgrade of the assortment which is several times a season. It reflects the trend of "I see now, I buy now." H&M and Zara are considered to be the first fast fashion brands, followed by GAP, Forever 21 and many others. At the opening of its first store in the USA, the Zara brand announced that it would take only 15 days to create a collection. (Byun & Sternquist, 2008)

Despite the advent of slow fashion, which criticizes fast fashion for environmental pollution, poor product quality, poor working conditions of workers, the brands of this segment are rapidly growing. What are the reasons for the growth and development of the fast fashion segment? (Covadonga, 2015)

1. Speed

Recent years are not an easy time for all segments of the fashion industry affected by economic instability and increased market competition. However, many retailers successfully pass the strength test. The secret of the large retailers is thoughtful marketing in the fashion business. They strive to attract millennials mostly, as well as to motivate them to return for shopping again and again. The brands rely on the launch of new collections, tying to holidays, festivals and even the time of salary payments according to local average indicators.

2. Influensers

Many brands implement updated marketing policy, which involves active promotion on social networks and advertising through influencers. The companies are collaborating on a constant basis with various celebrities, musicians, actors, sportsmen and etc. Alongside, each brand has a network of thousands of "mini-influencers" on Social Networks. Different types of influencers ensure a high level of interaction with target audience in all areas.

3. Sustainability and ethics

Fast fashion is heavily criticized for its negative impact on the environment, poor-quality items and poor working conditions of employees. Hitwise research from 2018 showed that 19% of top requests for fast fashion relate to ecology, ethics and sustainability. As a response to this criticism, many fashion retail companies adhere to the policy of business transparency and introduce initiatives related to ethical and environmental issues. For example, in the spring of 2019, H&M launched a new Conscious Collection line, which involves the use of 100% sustainable cotton. Zara boycotts Uzbek cotton, the production of which is associated with the use of forced labor. (Langella, 2017)

4 Practical Part

In this chapter the full analysis of Inditex is given. One of the world's largest clothing manufacturers produces a wide assortment of goods, which are described here. The chapter contains analysis of formation and development stages, types of company activities, characteristics of Inditex distribution system. (INDITEX, 2019)

4.1 Description of Inditex

Inditex is a Spanish corporation, one of the world's largest clothing manufacturers. The full name is Industrias de Diseno Textil Sociedad Anonima. Having created a textile holding, Amancio Ortega merged all his companies under the flag of Inditex. The corporation unites more than 7,000 stores in 96 countries under 9 different brands.

Inditex is engaged in the design, manufacture and sale of clothing, shoes, accessories, textiles and home interior items. The founder and largest shareholder is Amancio Ortega. The current chairman is Pablo Isla. The vice-chairman is José Arnau Cierra. The company was founded in 1985, but the history of the company dates back for almost 50 years. Inditex is headquartered in Arteijo, Spain. The company has over 171,840 employees worldwide. Most of the company's employees are female, the average age of employees is 26 years.

Inditex is a joint stock company. According to the official web-site information, Inditex's share capital amounts to EUR 93,499,560 and is divided into 3,116,652,000 shares. Most shareholders of the company are its co-founders. As of 31 January 2017, Inditex's share price per the listing price on Spain's Electronic Trading System (continuous market) was EUR 30.535 per share, and the stock market capitalization was EUR 95.1 billion. As of 31 January 2017, members of the Board of Directors hold a 59.36% stake in Inditex's share capital, where the largest shareholder is Amancio Ortega with 59.29% of the shares.

The success of the company and its business model, based on innovation and flexibility, made it one of the largest retail chains in the world. Their main approach to fashion is based on creativity, design quality and rapid adaptation to changing market requirements. All this allowed the company to expand its international presence at a fast pace.

4.2   Historical stages of Inditex development

In 1963-1974, Amancio Ortega, the founder of the company, begins his own clothing business. The family business was growing fast. Within 10 years he acquires several factories in Spain, which distribute their goods to other countries in Europe.

During the period of 1975-1984, Ortega starts selling clothes at retail and opens the first store of the Zara brand, which will later become the main brand of the company. The concept and approach to Zara brand fashion was becoming successful and well accepted by consumers. This encourages the founder to expand his chain of stores in the main cities of Spain.

In 1985, business undertakings of Amancio Ortega are merged into Inditex Corporation, which owns a group of companies operating today. Inditex acquires new factories, transport and logistics companies, real estate agencies and opens new stores. Zara opened its first store outside Spain in December 1988 in Porto, Portugal. The company begins to welcome customers in the USA and France by opening its stores in New York (1989) and Paris (1990). During the following decade, Inditex kept expanding its brand portfolio. The 2000th store in Hong Kong was opened, in 2004. The company was expanding its global presence in 56 countries of Europe, America, Asia and Africa. By 2008, Inditex had 4,000 stores. The company operated already in 73 countries, after the opening of stores in Korea, Ukraine, Montenegro, Honduras and Egypt.

In 2010, sales of Zara products began on the Internet and by the end of the year the online store was available in 16 European countries. Inditex stores had been opened in 82 countries. Based on a multi-channel retail strategy, the company launched online stores for all brands of the group, eventually.

By 2015, the company reached the 7,000-stores milestone, where the special profit-sharing plan was set up. It paid out €37.4 million to the 78,000 employees in stores, factories, logistics, brands and subsidiaries across 50 countries.

During 2016-2018, Inditex received international recognition of sustainability efforts. The innovation of integrated store and online model impacted the popularity of online shopping among its customers. The business was trading in 202 markets with stores in 96 of them and owned online platforms in 66 markets.

In 2019-2020, Inditex keeps transforming its digital and sustainability aspects. Currently, it is developing a concept virtual store network. The company is investing in cutting-edge technology in all areas of the business model.

4.3   Organizational structure

At the moment, the president of the company is Pablo Isla. The company is managed by a board of directors consisting of 9 members:Pablo Isla, Jose Arnau, Amancio Ortega, company GartlerS. L., Carlos Espinoza, Irene Miller, Emilio Torres, Nils Andersen, João Lopez. The Board of Directors performs managerial, administrative and representative functions. The Board publishes a corporate management report each year. The company has established the position of secretary of the council, who is not a member of the council, currently the position is held by Antonio Abadin. The company has an executive board consisting of 8 members of the Board of Directors. This is the most important governing body of the organization, consisting of chief executives.

Figure 1 Organisational structure of Inditex, 2019

Sources: https://www.theofficialboard.com/
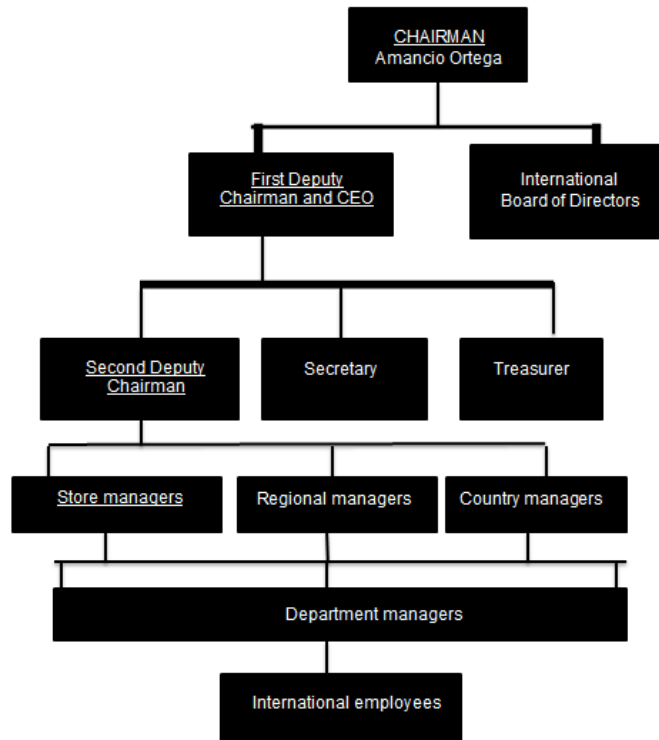
The company has an audit and control committee, which includes 6 members of the board of directors. The functions of this body include liaising with external auditors to obtain information; control of efficiency of internal audit of the company; risk

management; monitoring the preparation and disclosure of financial information; preparing an audit report. Report to the Board of Directors is based on the results obtained by the external auditors, who should review the company's annual report.

Inditex also has a committee on appointments and wages, which includes 6 members of the board of directors. Committee functions are the following:

- report on internal management appointments;
- proposal to the board of directors of candidates for members of committees;
- establishing the criteria in selecting senior managers;
- management of assignments and reassignments;
- the report an annual review on senior managers' actions;
- the annual report on the salary of directors and managers;
- the preparation of public information.

The company has a general meeting of shareholders. The Assembly is the highest independent body. The meeting may be annual or extraordinary. The annual meeting is held each year for the purpose of analyzing the company's activities and distributing profits. An extraordinary meeting is held on the convening of the board of directors to discuss the necessary issues and solve existing problems.

4.4   Brand portfolio and product assortment of Inditex

A brand portfolio of Inditex is broad. It includes the following companies: Zara, Pull & Bear, MassimoDutti, Bershka, Stradivarius, Oysho, ZaraHome, Uterque. Listed brands belong to mass-market segment. The table below describes the target audience, assortment, price range and description of the brands.

Table 1 Brand portfolio and product assortment of Inditex, 2019

Brand	Target	Income	Assortment	Description
Zara	25- 40 years old men and women	Middle disposable income	Clothing, shoes, accessories and cosmetics	Wide variety of classics along with ultra-fashionable and trendy items. It follows high-fashion trends.
Pull&Bear	12-25 years old men and women	Low to middle disposable income	Clothing, shoes, accessories and cosmetics	Urban sports, fashionable, laid back and playful styles.

Massimo Dutti Uterqüe	25- 40 years old men and women	Middle to high disposable income	Clothing, shoes, accessories and cosmetics	Premium classic items as well as ultra-fashionable and trendy items from high quality materials.
Bershka	12-25 years old men and women	Low to middle disposable income	Clothing, shoes, accessories and cosmetics	Trendy items, laid back and playful styles.
Stradivarius	12-25 years old women	Low to middle disposable income	Clothing, shoes, accessories and cosmetics	Fashionable items with highlighted feminine style to them.
Oysho	25- 40 years old women	Middle disposable income	Underwear, leisure wear, sports clothing	Ultra-fashionable and trendy items in glamorous feminine styles.
Zara Home	Men and women of 25 year and older	Middle to high disposable income	Home interior items	Stylish interior items for creating a comfortable home environment

Souces: Personal research and the brands' official website

Each of the company's stores is focused on a specific segment of the consumer. This structure allows the company to incur less costs, which is an advantage over other competitors. The Figure 2 represents assortment mix percentage for each brand, which could describe further differentiated brand strategies. As you can see the brands have very similar proportions of clothing categories.

Figure 2 Assortment mix in % of the brands under Inditex, 2019

Sources: https://ww.fashionnetwork.com/
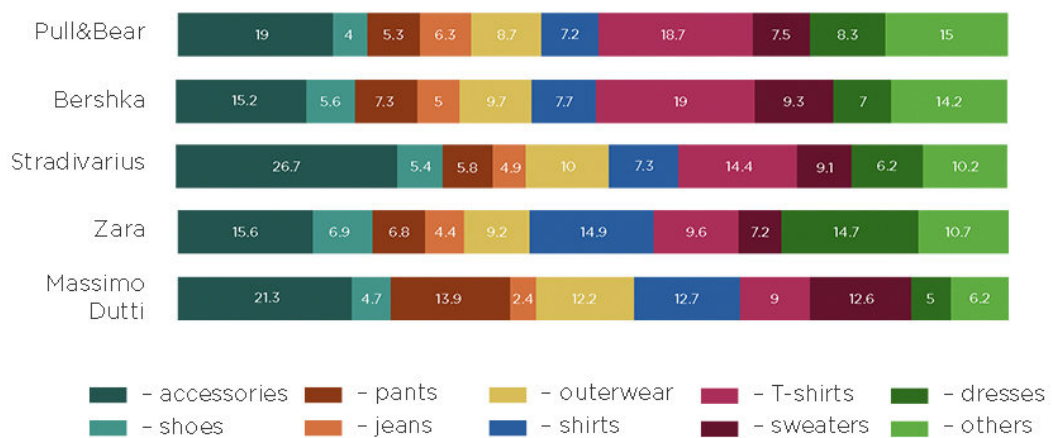
Zara is considered to be a flagship store of Inditex. It generates most of the company's revenue. The brand is the most widespread from the brand portfolio of Spanish corporation. From the table 2, it is possible to identify the share of each brand within Inditex according to the scale of retail space for each brand.

Table 2 Distribution of retail space by brands under Inditex in squared meters, 2018-2019

	2019	2018	2019/2018
Zara and Zara Home	3345519	3256381	3%
Pull&Bear	428969	419387	2%
Massimo Dutti	278052	274563	1%
Bershka	553853	54131	2%
Stradivarius	337893	332279	2%
Oysho	127294	122841	4%
Uterqüe	15152	15320	-1%
Total	5086732	4962081	3%

Sources: The annual reports of Inditex from 2018-2019

4.5   Production

In most clothing companies, the production process begins in the design workshop. Designers plan a new collection in at least a year. In Inditex, the opposite approach is practiced. Here, the starting link is customers. Managers of the Zara brand, which generates more than half of the corporation's revenue, daily track highly demanded items. Twice a week, they send offers and orders to three hundred designers who immediately develop a new product. In total, for all Inditex brands, designers develop about 12 thousand clothing models annually, while the competitors reach only 2-4 thousand. The risk of not selling the goods is minimal as the company offers customers what they demand themselves.

The fundamental aspect of the business model is the geography of production. As a rule, all low-cost clothing chains sew their products in factories in the third world, taking advantage of cheap labor. Two-thirds of Inditex products are produced in Spain, Portugal and Morocco. The corporation does not save on qualifications and wages, it prefers to rely on the local labor market in Spain. Own factories allow the company to not overpay for the delivery of goods to Europe.

In logistics, Inditex is guided by the "right in time" principle. Therefore, it needs to minimize the likelihood of failures in areas that cannot be fully controlled. The goods are distributed according to a strictly centralized scheme, in which stores around the world

receive products from central warehouses in Spain. Each store receives exactly those models, sizes and color scales, the demand for which is higher there. The delivery system is works in the way, that new goods go to European stores within 24 hours, to the USA and Asia in 48 hours.

4.5.1 Development of new models

Inditex designers study hundreds of fashion publications from around the world, analyze fashion shows worldwide, review current street wear trends, attend all the most important fashion shows in Paris, New York or Milan. Afterwards, the designers copy the new style right on the spot, which is then faxed to the central factory in La Coruña. Electronic digital cameras are also used, as photos taken on catwalks are sent to workshops immediately.

Each company store daily sends a special summary to La Coruña. The summary indicates the most frequent wishes of customers regarding clothing designs. This data can be accessed via the corporate Internet in real time. In addition, the summaries sent by store directors include information about the volume of sales for each position, which allows the distribution coordinators to quickly manage the assortment and exclude items that are not in demand during the week. Models designed by designers are transferred to the production part without any intermediate processes.

4.5.2 Production features

The production system is fully computerized. Supplies of fabric and sewing processes are carried out on time due to this. Sewing machines with software control can be reconfigured in a matter of minutes. After receiving materials from fashion shows, processing of new models begins immediately.

Control over all three parts of production, as modeling, sewing and selling clothes, is centralized. Everything is controlled from one center, which is the production center of La Coruña. Inditex has continuous improvement of management work in terms of quality and modernization of products.

The company buys uncolored fabric as a raw material at minimum prices. Then it is painted and processed according to urgent needs at its own capacities. The process of clothing production takes 10-15 days. After the quality check, finished products are sent to one of the company's two distribution centers, which are located in La Coruña or Zaragoza.

The area of these facilities is about 500 thousand square meters. They have installed unique sorting equipment.

4.5.3 Distribution system

The system of each distribution center operates in automatic mode, batches of clothes on trucks and aircraft are transported to their destinations. The company's products are not promoted on international podiums, they immediately enter stores and become available to everyone. The speed of delivery is also of utmost importance. The process of design and production of ready product to exposition in the store can be done in 1-2 weeks.

4.6 Trade

With the opening of the first Zara store, Inditex continues to conquer the world. It opens 500-600 stores annually in various parts of the world, from Kazakhstan to Bolivia, using the franchise model.

INDITEX franchises are located in Andorra, Saudi Arabia, Bahrain, Cyprus, Colombia, Costa Rica, United Arab Emirates, Slovenia, Finland, Guatemala, Iceland, Honduras, Israel, Jordan. Kuwait, Lebanon, Malaysia, Malta, Morocco, Panama, Qatar, Dominican Republic, El Salvador, Venezuela.

From the previous chapters, it is clear that each brand, operating under Inditex, plays a special role in the representation of the company on different audience levels and variety of pricing levels. The Figure 3 demonstrates comparative analysis of revenues of Inditex worldwide. There can be seen how substantial Zara's input in the company's progressive development.

Figure 3 Net sales of Inditex worldwide, 2013-2019

Legend: ● Zara ● Bershka ● Pull & Bear ● Massimo Dutti ● Stradivarius ● Oysho ● Uterqüe ● Zara Home

Sources: https://www.statista.com/
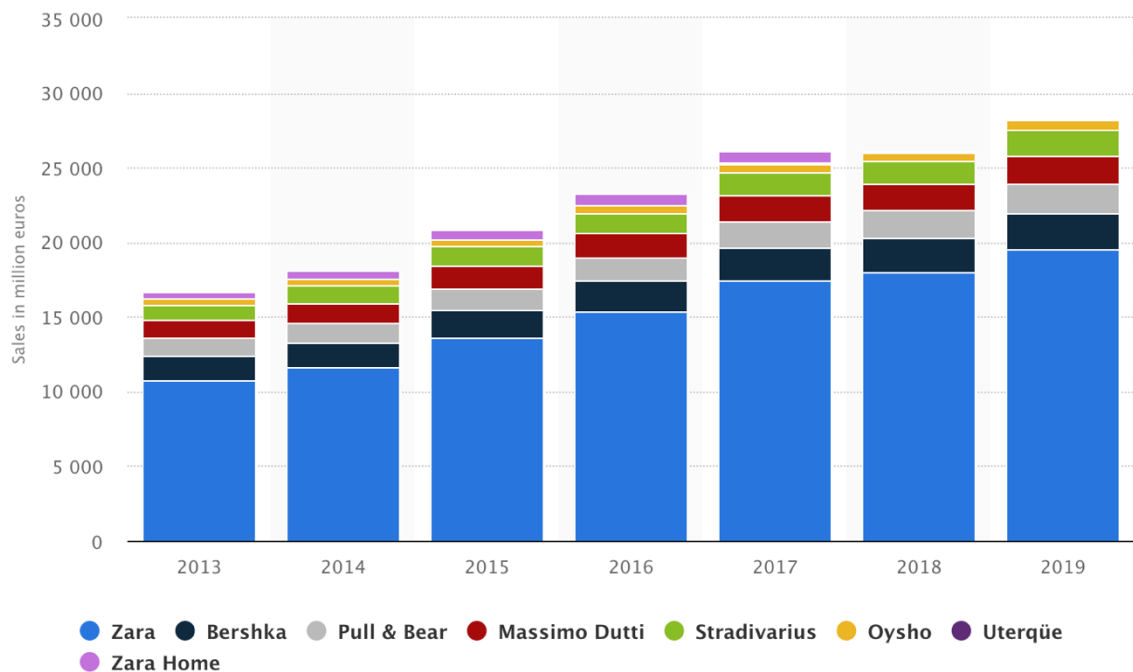
Currently, Inditex has over 7000 stores in more than 96 countries:

- Zara – 2,220 stores

- Pull&Bear – 970 stores

- Massimo Dutti – 770 stores

- Bershka – 1000 stores

- Stradivarius – 925 stores

- Oysho – 650 stores

- Zara Home – 600 stores

- Uterque – 91 stores

4.6.1 Point of sale features

In Inditex stores, items are sorted mostly by color scheme, which makes it easier for customers to choose. In middle- and high-income oriented brands, sales team play the role of consultants. They are interested in the general expansion of sales, as that will bring them the extra bonuses to the salary. Therefore, they are always ready to offer the buyer a harmonious addition to the chosen update or an alternative. The company always looks for the busiest streets of urban centers for the store locations. Instead of advertising, mostly funds go to the design of storefronts. In the central office in La Coruña, there is an entire

department dedicated exclusively to the design of display windows. Successful solutions, approved by management, are sent to stores that bring their windows in line with the submitted projects. Constantly updating displays, on which new products are displayed, is an excellent way to attract visitors, both permanent ones, who track changes in the assortment, and newcomers who may be interested in certain models.

Today, Inditex is still closely connected with Europe, where 80% of its stores are located. The company fails to conquer the world's most capacious markets as North America and Japan (Figure 5). According to experts, the problem is that in the American and Japanese markets, US companies, operating in the same niche of inexpensive but fashionable clothes, are very strong. However, proceeding from the fact of how quickly and effectively the European market was captured, the further successful penetration of American and Japanese markets can be foreseen.

Figure 4 Sales geography of Inditex, 2018

● Asia and rest of the world   ● Americas   ● Rest of Europe   ● Spain
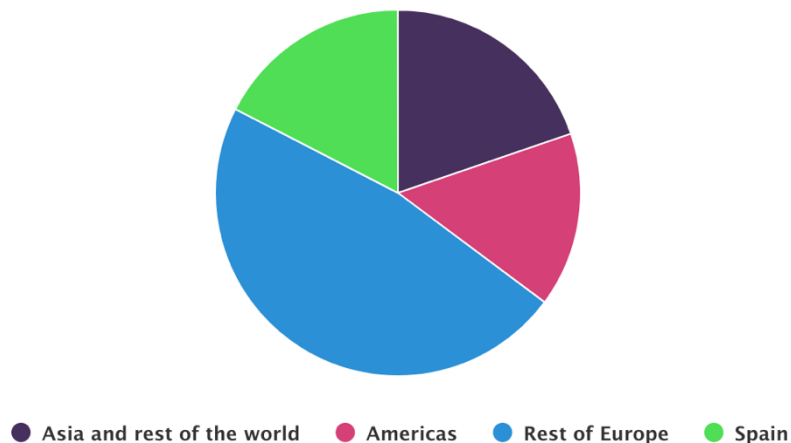
Sources: https://craft.co/inditex/metrics

4.7   The main competitors of INDITEX

H&M (Hennes&Mauritz) Group

H&M is a Swedish company, Europe's largest clothing retailer. It was founded in 1947. Currently, H&M Group sells clothing and cosmetics in approximately 5,000 stores in 74 countries. In 2019, sales were more than €24,4 billion.

GAP Inc.

GAP is an American company, the owner of a chain of clothing stores. The company was founded in 1969 by Donald and Doris Fisher. The company's chain of stores has more than 3,500 stores worldwide. Clothing is sold under the trademarks Gap, BananaRepublic,

OldNavy, Piperlime, Intermix, Hill City and Athleta. In 2019, the company reported €13.9 billion of revenue.

Uniqlo Co., Ltd.

Uniqlo is a Japanese casual wear designer and manufacturer. The company was found in 1949. Nowadays, it is subsidiary of Fast Retailing Co., Ltd. The brand has 2,250 stores worldwide. In 2019, the revenue of the subsidiary was over €8 billion.

Benetton Group

Benetton Group is an Italian company, founded in 1965. Benetton has a network of 5,000 stores in 120 countries. Stores are managed by independent partners. The company is known for its involvements in sports industry, as well as original and provocative advertising campaigns under the motto "United colors of Benetton." In 2018, the sales of the company were reported as €1.3 billion. Lately, the company is having hard times on several markets. It closed about 1000 stores within last two years. In 2019, the net profit fell to €55 million from 184 million euros in 2018. Being a strong competitor to Inditex for years, Benetton Group does not seem recover any time soon.

Punto Fa, S.L., trading as Mango

The Spanish Mango is a popular clothing brand that specializes in the production of women's, men's and children's clothing lines. In addition, accessories, perfumes, underwear are released under the Mango label. Initially, Mango brand was conceived as a women's clothing line designed for the average price category. Today, the company's popularity coverage is a large number of stores in 105 countries. In 2019, the company reported 2.37 billion euros of revenues, which meant increase by 6.3 percent compared to the results of 2018.

Figure 5 Comparative assortment mix of Zara, H&M and Mango in %, 2019
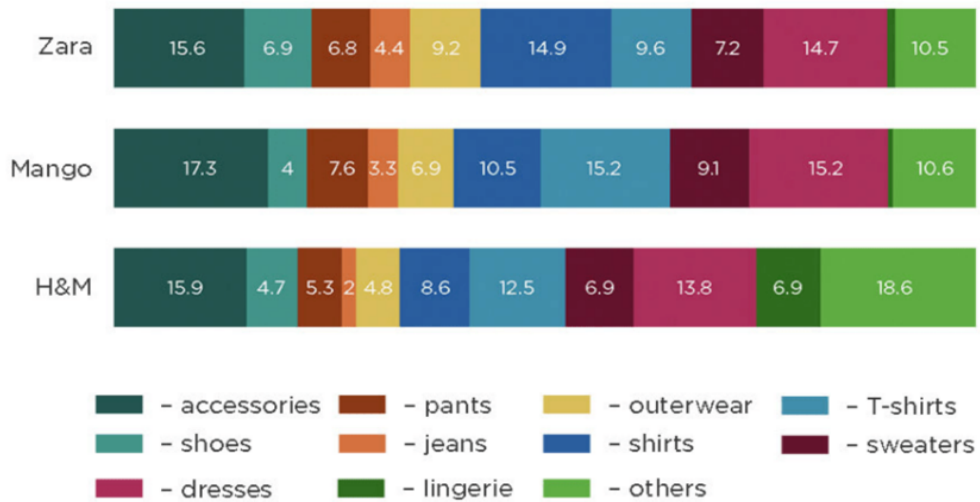
There are no considerable differences between Zara, H&M and Mango's assortment strategies. According to the graph above, the most substantial difference is in the "others" category, which includes sportswear, swimwear, nightwear and intimates.

4.8   Horizontal and Vertical analysis of INDITEX, S.A.

The horizontal and vertical analysis will be conducted in this chapter. The analyzed data is taken from the balance sheet and income statement. The calculations are presented in the form of tables and graphs, which are followed by resulting values descriptions. The company performance was analyzed for the latest available interval of 2015 - 2019.

4.8.1   Horizontal analysis of Assets

The table below represent horizontal analysis, where the absolute values are in million euros and the relative values are in percentage changes. The data is compared with the following year values. The changes are calculated in the following manner: between 2016 and 2015, between 2017 and 2016, between 2018 and 2017, between 2019 and 2018.

Table 3 Horizontal analysis of Assets of Inditex, 2015 - 2019

	2016/2015		2017/2016		2018/2017		2019/2018	
	Mill EUR	%	Mill EUR	%	Mill EUR	%	Mill EUR	%
Cash and cash equivalent	427	11,2	-109	-2,6	815	19,8	-65	-1,3
Current financial investments	864	389,2	951	87,6	-565	-27,7	457	31,0

Other financial assets	-123	-72,8	41	89,1	-75	-86,2	8	66,7
Other current assets	12	9,4	2	1,4	19	13,5	2	1,3
Income tax receivable	21	30,9	18	20,2	3	2,8	-2	-1,8
Trade and other receivables	-193	-22,4	192	28,7	-83	-9,6	42	5,4
Inventories	336	18,1	354	16,1	136	5,3	31	1,2
Total Current Assets	1344	18,9	1449	17,1	250	2,5	473	4,7
Rights over leased assets	-27	-5,1	1	0,2	-48	-9,5	7	1,5
Other intangible assets	37	24,2	21	11,1	44	20,9	91	35,7
Goodwill	-4	-2,0	2	1,0	11	5,6	-1	-0,5
Property, plant and equipment	556	9,2	686	10,4	361	5,0	695	9,1
Investment property	-60	-74,1	0	0,0	0	0,0	-1	-4,8
Financial investments	33	21,9	47	25,5	6	2,6	30	12,7
Other non-current assets	52	11,0	30	5,7	-34	-6,1	44	8,5
Deffered tax assets	49	7,6	29	4,2	22	3,0	114	15,3
Total Non-Current Assets	1980	12,9	2264	13,0	610	3,1	1453	7,2
Total Assets	**3324**	**31,8**	**3713**	**30,2**	**860**	**5,6**	**1926**	**11,8**

Source: Own calculations based on the data from annual reports 2015-2019

The considerable changes were mostly found in Current assets values. There was a considerable increase of 389% from 2015 to 2016 in short-term financial investments. The following periods were not as noticeable. There were not any considerable changes in property investment within 2016-2018. However, in 2019, there can be found minor decrease in the real estate property.

Besides all the changes, the development of the total assets of Inditex was exclusively progressive during the analyzed period according to Figure 7.

Figure 6 The total assets of Inditex in million Euros, 2015-2019
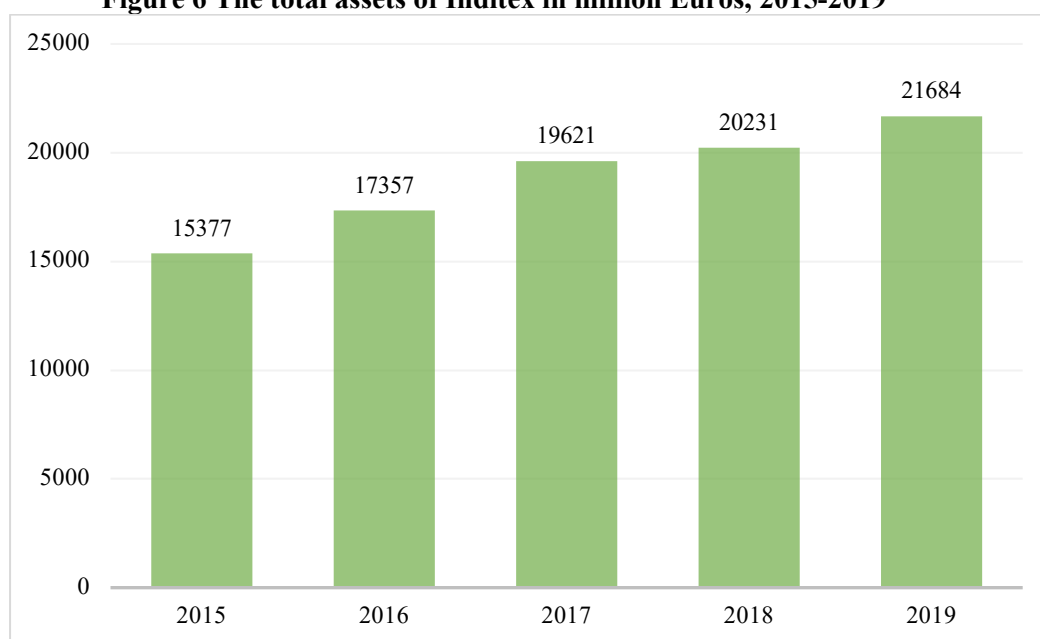
Sources: The annual reports of Inditex 2015-2019

4.8.2 Horizontal analysis of Liabilities and Equity

The Table 4 represents horizontal analysis of Liabilities and Equity. We can see that within 2018-2019, the equity of the company grew along with its total liabilities.

Table 4 Horizontal analysis of Liabilities and Equity of Inditex, 2015 – 2019

	2016/2015		2017/2016		2018/2017		2019/2018	
	Mill EUR	%	Mill EUR	%	Mill EUR	%	Mill EUR	%
Total Equity	982	9,4	1301	11,4	770	6,0	1160	8,6
Equity attributable to the Parent	979	9,4	1303	11,4	784	6,2	1156	8,6
Equity attributable to non-controlling interests	3	7,9	-3	-7,3	-13	-34,2	5	20,0
Total Non-current Liabilities	77	6,6	183	14,8	117	8,2	82	5,3
Provisions	-56	-27,9	97	66,9	17	7,0	-30	-11,6
Other non-current liabilities	89	12,4	115	14,3	85	9,2	67	6,7
Financial debt	747	37350,0	-749	-100,0	4	0	1	25,0
Deferred tax liabilities	44	18,3	-28	-9,8	11	4,3	44	16,4
Total Current Liabilities	921	24,6	781	16,7	-278	-5,1	210	4,1
Financial debt	2	25,0	52	520,0	-50	-80,6	72	600,0

65

Other financial liabilities	-15	-18,1	-4	-5,9	41	64,1	-58	-55,2
Income tax payable	-73	-48,7	153	198,7	-79	-34,3	2	1,3
Trade and other payables	1006	28,7	581	12,9	-189	-3,7	193	3,9
Total equity and liabilities	**1980**	**12,9**	**2264**	**13,0**	**610**	**3,1**	**1453**	**7,2**

Source: Own calculations based on the data from annual reports 2015-2019

There was a substantial increase of 37350% in non- current financial debts of the company in 2016, which was fully covered by the end of 2017.

Considerable decrease of 80% in Current financial debt in 2018 was followed by 600% increase by the end of 2019. The changes in equity of the company are quite stable throughout the analyzed period.

The Figure 8 demonstrates historical development of the key items from the balance sheet, such as Equity, non-current and current Liabilities. The tendency is clearly progressive.

Figure 7 Stucture of the total Liabilities and Equity of Inditex in million Euros, 2015-2019

Sources: The annual reports of Inditex 2015-2019

4.8.3 Horizontal analysis of Income Statement

The given table represents horizontal income statement analysis. The evolution of changes in income statement values is progressively positive for the last 5 years.

The most substantially increased indicator is a financial result, which is the difference between earnings before interest and taxes and earnings before taxes.

Table 5 Horizontal analysis of Income Statement of Inditex, 2015-2019

	2016/2015		2017/2016		2018/2017		2019/2018	
	Thousand EUR	%	Thousand EUR	%	Thousand EUR	%	Thousand EUR	%
Net Sales	2410093	11,5	2025468	8,7	809000	3,2	2141000	8,2
Cost of sales	1220843	13,9	1044018	10,4	253000	2,3	1150000	10,2
Gross margin	1189250	9,8	981450	7,4	556000	3,9	990000	6,7
Operating expenses	783749	10,6	768419	9,4	385000	4,3	-1153000	-12,4
Other losses and income, net	17857	1056,0	18452	94,4	-8000	-21,1	3000	10,0
Gross Operating profit (EBITDA)	384261	8,2	193580	3,8	180000	3,4	2141000	39,2
Amortisation and depreciation	40969	4,0	-99686	-9,4	137000	14,2	1726000	156,9
EBIT	343292	9,3	293266	7,3	43000	1,0	415000	9,5
Financial results	-72	-0,7	-4997	-50,0	12000	240,0	135000	794,1
Results o f companies accounted for using the equity method	-8019	-14,4	-5588	-11,7	12000	28,6	7000	13,0
Profit before taxes	335201	9,0	272681	6,7	77000	1,8	253000	5,7
Income tax	56297	6,5	61786	6,7	1000	0,1	54000	5,5
Net income	300000	10,3	200000	6,3	0	0,0	200000	5,9
Earning per share in Euros	0,091	9,9	0,068	6,7	0,024	2,2	0,062	5,6

Source: Own calculations based on the data from annual reports 2015-2019

Gross Margin showed steady increase with resulting 6,7% (compared to 2018) in the end of 2019. While net income was incremental up till 2017, followed by almost no changes in 2018, and the increase of 5,9% in 2019. The annual increase in cost of sales is justified by complying increase in Net Sales, which is demonstrated in the Figure 9.

Figure 8 The development of key items in the Income statement of Inditex in million Euros, 2015-2019

Sources: Own calculations based on the data from annual reports 2015-2019

The table below gives the more detailed look at the company's selected expenses. The data is compared between the values of 2018 and 2019

Table 6 Expenses of Inditex in 2018-2019, million Euros

	2019	**2018**	**19/18**
Salaries	4430	4136	7%
Rental costs	695	2392	-71%
Other operational expenses	3051	2801	9%
Total	8176	9329	12%

Source: Data from Inditex annual reports 2018-2019

H&M Group is one of the main competitors of Inditex in Europe. The companies have very similar product range, diversification and pricing strategies. However, we can see from the Figure 10, that Inditex's activities are more profitable.

Figure 9 Inditex and H&M Income Statement ratios comparison

Source: https://fashionretail.blog/
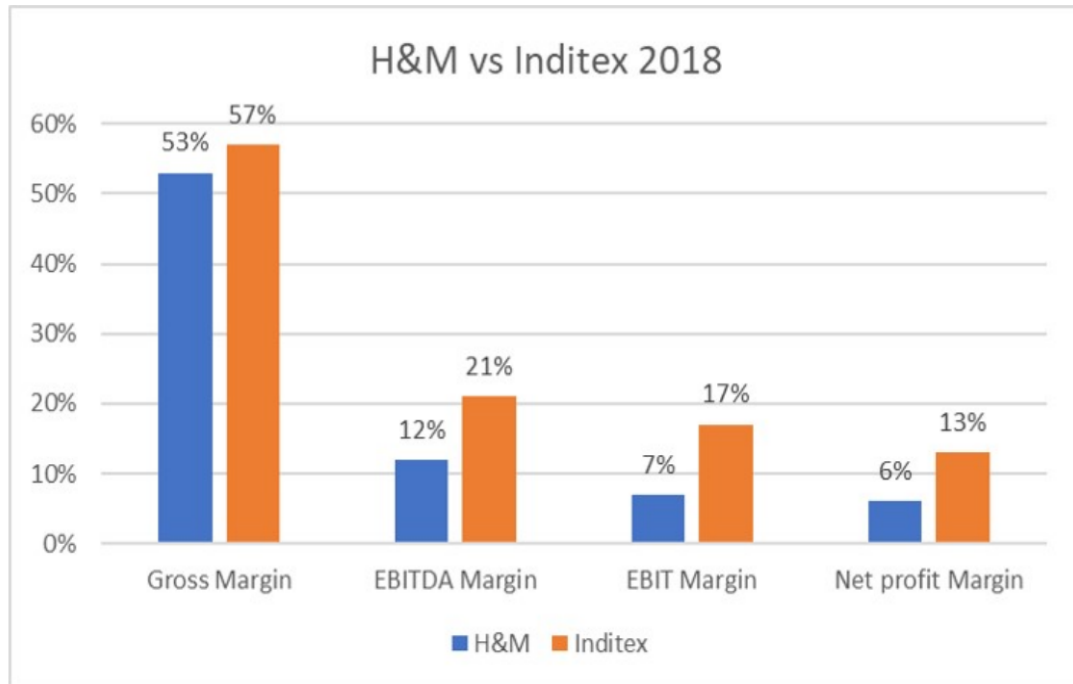
4.8.4   Vertical analysis of Assets

The table below represents proportion of each item in total assets of corporation. Within 2015-2016 the largest share of total assets was non-current assets. However, there was an increase in short-term assets, which was 50,45% by the year 2017, and 50,16% in the end of 2018. The share of long-term assets increased back to 51,02% in 2019.

The considerable changes were noticed in current financial investments, where in the span of 2015-2019 it increased from 1,44% to 8,90% share of total assets. The highest share of the current financial investments 10,38% was reported in 2017.

Trade and other receivables decreased in 2016, where it was 3,85%. It was followed by slight increase in 2017, but it resulted in 3,78% of total assets in 2019. Inventories were quite stable throughout the whole period of 5 years, with the peak of 13,27% in 2018, while the average for the period was 12,7%.

Goodwill was gradually decreasing its share in total assets. It went from 1,29% to 0,95% in 2019. Inditex was progressively changing Financial investment in total assets. It reached its peak of 1,23% of assets in 2019.

The lowest contribution to the total assets was performed by investment property. Investment property gradually decreasing each year. It changed from 0,53% in 2015 to 0,09% in 2019.

The most considerable contributions to the company's total assets was brought by Cash and cash equivalent and by Property, plant and equipment. The lowest indicators were in 2017, when Cash and cash equivalent were 20,98% of the assets and Property, plant and equipment were 37,12% of the total assets. Both of the items were significantly impacted by the increase of short-term financial investment of the company.

Table 7 Vertical analysis of Assets of Inditex, 2015-2019

	2015	2016	2017	2018	2019
Cash and cash equivalent	24,70%	24,34%	20,98%	24,37%	22,44%
Current Financial investments	1,44%	6,26%	10,38%	7,28%	8,90%
Other financial assets	1,10%	0,27%	0,44%	0,06%	0,09%
Other current assets	0,83%	0,80%	0,72%	0,79%	0,75%
Income Tax Receivable	0,44%	0,51%	0,55%	0,54%	0,50%
Trade and other receivables	5,61%	3,85%	4,39%	3,85%	3,78%
Inventories	12,09%	12,65%	12,99%	13,27%	12,53%
Total Current Assets	46,21%	48,68%	50,45%	50,16%	48,98%
Rights over leased assets	3,45%	2,90%	2,57%	2,26%	2,14%
Other intangible assets	0,99%	1,09%	1,08%	1,26%	1,60%
Goodwill	1,29%	1,12%	1,00%	1,02%	0,95%
Property, plant and equipment	39,29%	38,01%	37,12%	37,78%	38,46%
Investment property	0,53%	0,12%	0,11%	0,10%	0,09%
Financial investments	0,98%	1,06%	1,18%	1,17%	1,23%
Other non-current assets	3,07%	3,02%	2,82%	2,57%	2,60%
Deffered tax assets	4,19%	3,99%	3,68%	3,68%	3,96%
Total Assets	100	100	100	100	100

Source: Own calculations based on the data from annual reports 2015-2019

4.8.5   Vertical analysis of Liabilities and Equity

The table below shows vertical analysis of liabilities and stockholders' equity of Inditex within 2015-2019. The largest share of the total equity and liabilities is under the compay's Equity. The lowest percentage was indicated in the end of 2017 where it was 64,99% of the equity and liabilities, which was initiated by growth of Current Liabilities' share to 27,78% in 2017. Equity attributable to non-controlling interests was gradually decreasing its share in total equity and liabilities: from 0,25% in 2015, it moved to 0,14% of the total amount.

Table 8 Vertical analysis of Liabilities and Equity of Inditex, 2015-2019

	2015	2016	2017	2018	2019
Equity	68,08%	65,97%	64,99%	66,84%	67,71%
Equity attributable to the Parent	67,84%	65,74%	64,79%	66,71%	67,58%
Equity attributable to non-controlling interests	0,25%	0,24%	0,19%	0,12%	0,14%
Non-current Liabilities	7,54%	7,12%	7,23%	7,59%	7,46%
Provisions	1,31%	0,84%	1,23%	1,28%	1,06%
Other non-current liabilities	4,66%	4,64%	4,69%	4,97%	4,94%
Financial debt	0,01%	4,32%	0,00%	0,02%	0,02%
Deferred tax liabilities	1,57%	1,64%	1,31%	1,32%	1,44%
Current Liabilities	24,38%	26,91%	27,78%	25,57%	24,82%
Financial debt	0,05%	0,06%	0,32%	0,06%	0,39%
Other financial liabilities	0,54%	0,39%	0,33%	0,52%	0,22%
Income tax payable	0,98%	0,44%	1,17%	0,75%	0,71%
Trade and other payables	22,81%	26,01%	25,97%	24,25%	23,52%
Total equity and liabilities	100	100	100	100	100

Source: Own calculations based on the data from annual reports 2015-2019

Non-current liabilities were stable part of the total equity and liabilities, with the average share of 7,4%.

By the end of 2017, the company covered its non-current financial debts. It became an insignificant 0,00% of total equity and liabilities. However, in the following 2018-2019, the long-term financial debts grew to a share of 0,02%.

In 2017, Income tax payable and Trade and other payables were relatively high in the total of equity and liabilities. The share of Income tax payable resulted in 0,71% of the total amount by the end of 2019.

4.8.6   Vertical analysis of Income statement

The table below shows the vertical analysis of Inditex's income statement. It can be seen that the largest share of the company's revenue is gross margin. It was 57,84% in 2015, followed by slight decreases in 2016-2018, and dropped to the 55,88% of Sales amount in 2019. Consequently, the cost of sales of gradually decreasing from 42,16% in 2015, and reaching 44,12% of the revenue in 2019.

Table 9 Source: Vertical analysis of Income Statement of Inditex, 2015-2019

	2015	**2016**	**2017**	**2018**	**2019**
Net Sales	100	100	100	100	100
Cost of sales	42,16%	43,04%	43,72%	43,33%	44,12%
Gross margin	57,84%	56,96%	56,28%	56,67%	55,88%
Operating expenses	35,37%	35,07%	35,30%	35,68%	28,90%
Other losses and income, net	0,01%	0,08%	0,15%	0,11%	0,12%
Gross Operating profit (EBITDA)	22,48%	21,81%	20,83%	20,87%	26,86%
Amortisation and depreciation	4,89%	4,56%	3,80%	4,21%	9,99%
EBIT	17,60%	17,25%	17,03%	16,66%	16,87%
Financial results	0,05%	0,04%	0,02%	0,07%	0,54%
Results o f companies accounted for using the equity method	0,27%	0,20%	0,17%	0,21%	0,22%
Profit before taxes	17,91%	17,50%	17,17%	16,94%	16,55%
Income tax	4,12%	3,93%	3,86%	3,75%	3,66%
Net income	13,88%	13,73%	13,42%	13,00%	12,73%

Source: Own calculations based on the data from annual reports 2015-2019

Operating expenses were taking in average 35% of net sales withing the chosen period. However, they accounted share of 28,90% by the end of 2019, which resulted in considerably high share of Gross Operating profit, 26,86% of net sales.

 The share of amortisation and depreciation in the revenue reached the lowest 3,80% in 2017. In the year of 2019, amortisation and depreciation took substantial share of the net sales, which was 9,99%.

The share of earnings before interest and taxes of Inditex were digressive till the end of 2018, when it hit the share of 16,66% .However, the end of 2019 showed slight increase of 16,87% in net sales. The share of net income along with the income tax were correspondingly fluctuating till they reached the lowest share 12,73% for net income and 3,66% for income tax of the revenue within the chosen period.

As a result of the analysis, it can be concluded that the share of sales costs is rising, while the share of net income is descending. This fact might indicate that Inditex has issues with implementing of their business strategy.

4.9   RATIO Indicators

In this part of the diploma thesis, indicators of liquidity, profitability, activity, debt and market value will be analyzed.

4.9.1   Liquidity ratios

The table below is calculated using the formulas given in the theoretical part and data provided by Inditex in the period of 2015-2019. Three main types of liquidity are calculated and discussed: current, quick and cash ratios. The ratios are based on different types of assets of the company.

Table 10 Liquidity ratios of Inditex 2015-2019

	2015	2016	2017	2018	2019
Current ratio	1,9	1,8	1,8	2,0	2,0
Quick ratio	1,4	1,3	1,3	1,4	1,5
Cash ratio	1,0	0,9	0,8	1,0	0,9

Sources: Own calculations based on the data from annual reports 2015-2019

Current ratio includes all the current assets. During the period of 5 years, according to the current ratio indicators, the company lays within the average recommended interval of 1,5-2,5. It showed quite a strong coverage of current liabilities in 2018-2019, which means that Inditex is generally considered healthy.

Quick ratio includes all assets except inventory. The indicators of quick ratio are all higher than 1, which can be interpreted as the ability of the company to pay off the current debts. The lowest quick ratio was presented in 2016-2017 as 1,3. The highest result was shown as 1,5 by the end of 2019. It indicates that Inditex is in good financial health and that it is less likely to face financial hardships (Figure 11).

Cash ratio is calculated based on the most liquid assets as cash and cash equivalents. Inditex demonstrates indicators laying within the recommended range. In 2015 and 2018, the company had cash ratio of 1,0, which means that the company had the same amount of cash and equivalents as its current debt. In 2017, Inditex had the lowest indicator of 0,8, it needed more than just its cash reserves to pay off its current debt. As the indicator is still higher than 0,5, the cash ratio strategy of the company is considered to be healthy.

Figure 10 The Development of Liquidity ratios of Inditex, 2015-2019
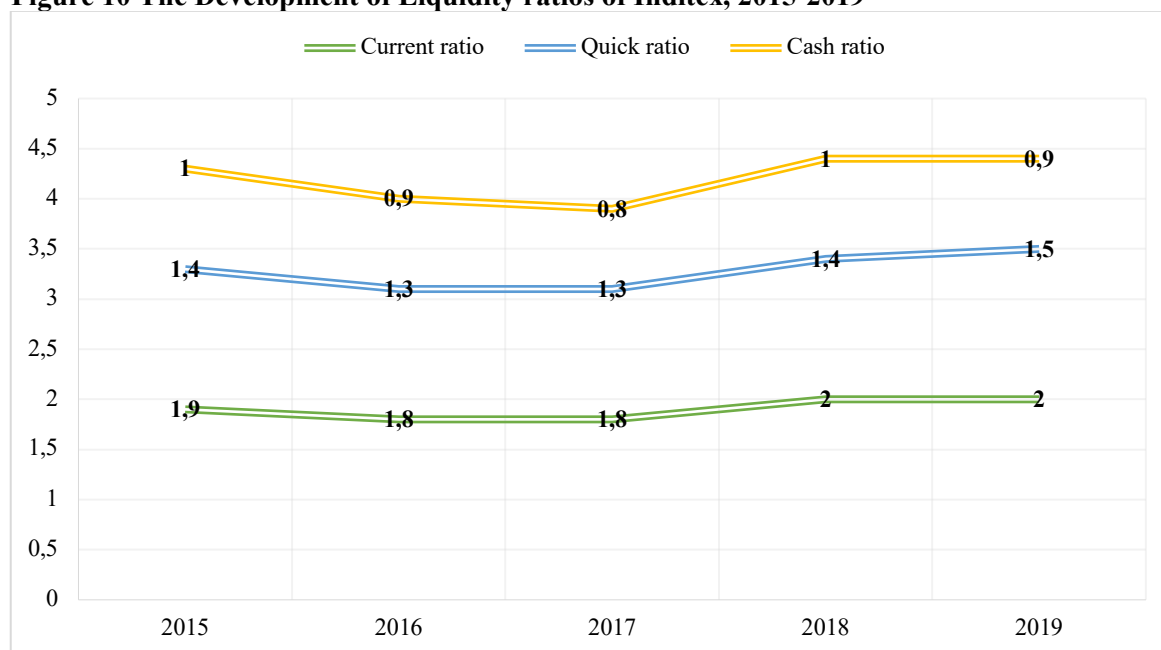
Sources: Own calculations based on the data from annual reports 2015-2019

4.9.2 Profitability ratios

One of the main ratios indicating the well-being of the company are the profitability ratios. The analysis of the four common indicators calculated from the data of 2015-2019 is presented in table below. Gross Profit Margin, Net Profit Margin, ROA, ROE of Inditex showed the ability of the company to achieve profitability with the invested capital. and thus the ability to create new resources.

Table 11 Profitability ratios of Inditex, 2015-2019

|	2015	2016	2017	2018	2019
Gross profit margin	58%	57%	56%	57%	56%
Net profit margin	14%	14%	13%	13%	13%
Return on equity	28%	28%	27%	25%	25%
Return on assets	24%	23%	22%	22%	22%

Source: Own calculations based on the data from annual reports 2015-2019

The company is part of Textile and Apparel industry, therefore the results are compared to average values of this industry. Inditex had positive values during 2015-2019. All the indicators are laying above average indicators. The year 2019 showed the lowest indicators in comparison with previous years. Gross Profit Margin decreased to 56% from 57% of 2017. Net profit margin of the company was fell from 14% in 2015-2016 to 13%, which was relatively constant throughout 2017-2019.

The highest Return on equity was 28% in 2015-2016. The following periods the percentage was falling until it reached the mark of 25% in 2018-2019, which is above the average industry number, but lower than its main competitor's 26,38%, H&M group. It represents part of profit which falls to 1 EUR of capital invested by a shareholder.

There was a gradual decrease in return on assets throughout the analyzed period, however, the fluctuation marks were above the industry average. In 2017, the indicator reached 22% and was stable till the end of 2019, while its competitor H&M's ROA was fluctuating from 28% to 10% within 2015-2019. Return on assets indicates how the company generates its profit from assets, in other words, its production power.

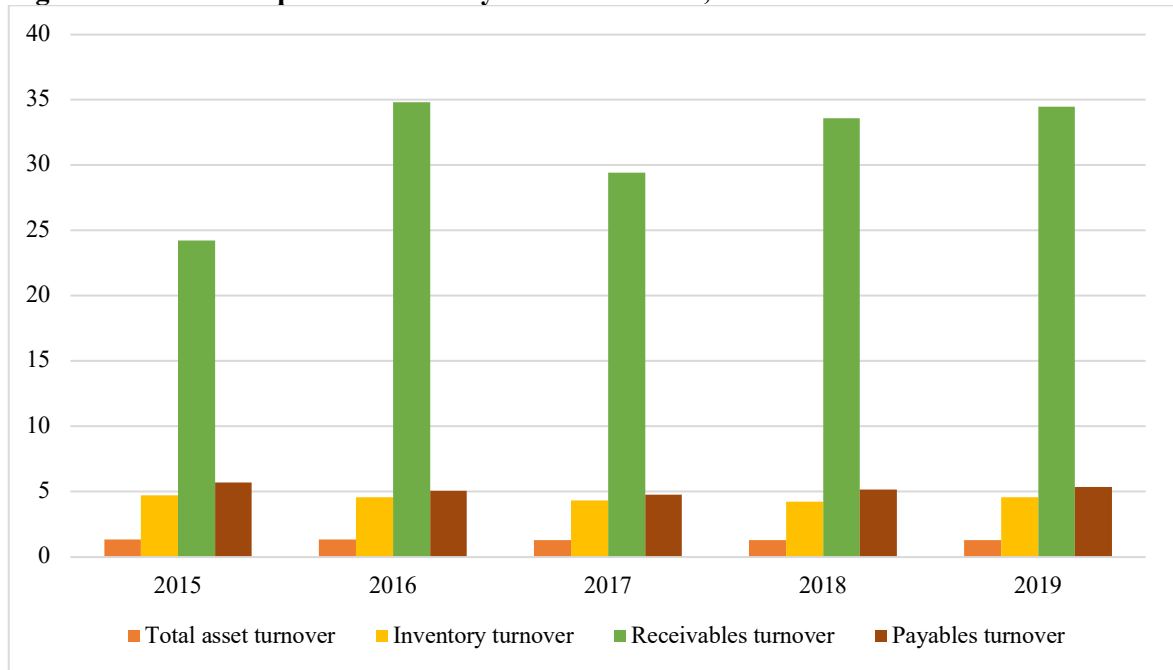**Figure 11 The Development of Profitability ratios of Inditex, 2015-2019**
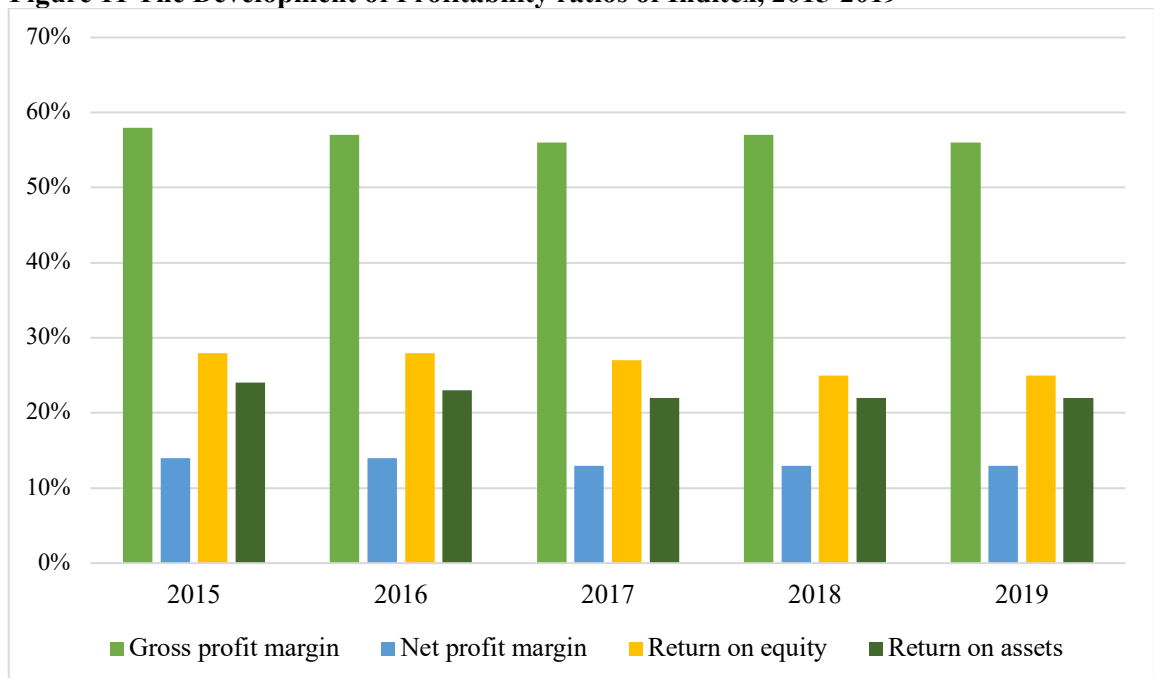
Source: Own calculations based on the data from annual reports 2015-2019

4.9.3 Activity ratios

Activity indicators determine whether the company is leveraging the assets effectively, to generate revenues and cash. During the period of 2015-2019, Inditex showed lower than average industry activity ratios, which means that the company was not optimally allocating capital resources and utilizing them.

Figure 12 The Development of Activity ratios of Inditex, 2015-2019

Source: Own calculations based on the data from annual reports 2015-2019

The optimum for assets turnover defined as 1,80. Within 5 years, the closest indicator got to the optimum was in 2015 with the ratio of 1,36. 2017-2018 showed the lowest value of 1,29.

Table 12 Activity ratios of Inditex, 2015-2019

	2015	2016	2017	2018	2019
Total asset turnover	1,36	1,34	1,29	1,29	1,30
Inventory turnover	4,74	4,57	4,35	4,22	4,59
Receivables turnover	24,25	34,84	29,43	33,61	34,50
Payables turnover	5,71	5,08	4,76	5,17	5,39
Payables turnover in days	64	72	77	71	68

Source: Own calculations based on the data from annual reports 2015-2019

Inventory turnover ratio represents how many times per year the Inditex's inventory will be turned over. The highest result of 4,74 was calculated for 2015, whilst the industry

optimum for inventory turnover is 9,71. As we can see the indicators of the company are very far from the optimum. In 2018, it reached its lowest 4,22 point.

Receivables turnover was the only indicator, the values of which were above the industry optimum 14,16. According to the calculated numbers, it can be concluded that Inditex is very effective in collecting its receivables or money owed by clients. The lowest receivables turnover ratio was performed in 2015 as 24,25, which followed by its spike to 34,84 in 2016. However, it dropped to the level of 29,43 in 2017. That situation was gradually recovered by 2019 resulting in 34,50.

During the analyzed period, the company keeps the payables unpaid for the average number of 70 days. The lowest indicators were 64 and 68 in 2015 and 2019 correspondingly.

4.9.4 Debt ratios

The ratio indicators in the table below show how independent is the analyzed company. The highest number of debt ratio was calculated for the end of 2017, the ratio reached 0,350. The lowest number of 0,319 was in 2015. From the methodology it is known that the optimal is 0,5, while indicators with values up to 0,7 considered to be normal. Consequently, it can be concluded that according to the values of the debt ratio Inditex is a low-risk company.

The equity ratio values of the company were slightly fluctuating during the 5 years period. The highest threshold of 0,681 was in 2015 correlated to the previously mentioned low debt ratio of the same year. The lowest number of 0,650 was performed in the end of 2017 correlated with the previously mentioned high debt ratio of the same year.

Table 13 Debt ratios of Inditex, 2015-2019

	2015	2016	2017	2018	2019
Debt ratio	0,319	0,340	0,350	0,332	0,323
Equity ratio	0,681	0,660	0,650	0,668	0,677
Debt to Equity	0,469	0,516	0,539	0,496	0,477
Debt to Capital	0,319	0,340	0,350	0,332	0,323

Source: Own calculations based on the data from annual reports 2015-2019

The value of 1 in debt-to-equity ratio would indicate that investors and creditors have an equal stake in the company's assets. All the values of Inditex for debt-to-equity ratios are far below one, averaging in 0,5. Debt to capital ratio allows us to see how well Inditex can handle a downturn in sales. The average of 0,3 performed by the company is considered to be low.

Proceeding from the numbers of debt to equity and debt to capital ratios, it can be assumed that Inditex is considered to be a rather conservative and financially stable company. There are no patterns of particularly positive or negative trends in the values of any debt ratios based on figure 14.

Figure 13 The Development of Debt ratio of Inditex, 2015-2019
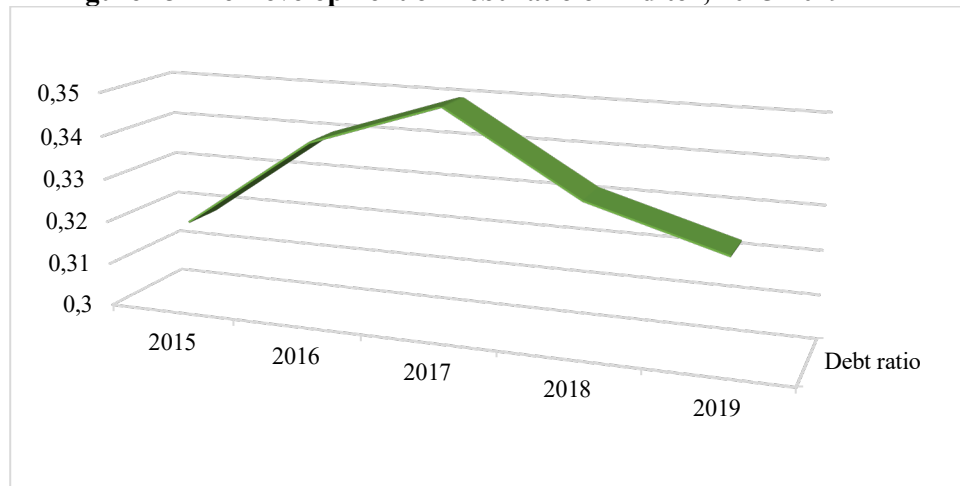
Source: Own calculations based on the data from annual reports 2015-2019

4.9.5 Market value ratios

The indicators of market values of Inditex in the table below represent the real value and profitability of the enterprise. The share capital of INDITEX, S.A. is represented by a total of 3,116,652,000 common shares. Each share has a nominal value of 0.03EUR.

Table 14 Market value ratios of Inditex, 2015-2019

	2015	2016	2017	2018	2019
P/E	32,55	32,7	30,11	26,68	22,02
EPS in Euros	0,923	1,014	1,082	1,106	1,168
Dividend yield	1,54%	1,99%	2,23%	2,60%	3,61%
Book value in Euros	3,36	3,67	4,09	4,34	4,71

Source: Own calculations based on the data from annual reports 2015-2019

The P/E ratio applied to Inditex shows a degressive trend with starting point of 32,55 in 2015 and ending with the lowest value of 22,02 within the analyzed 5-year period. Comparing with the results of its main competitor H&M group, Inditex had higher expected price of the shares based on its earnings up till 2018. However, in 2019 the companies appeared to be on relatively the same level of 22,02 (Inditex) and 22,76 (H&M). (H&M Group, 2019) The low P/E might be interpreted that the current stock price of Inditex is low relative to earnings.

Table 15 Comparison of P/E ratios of Inditex and H&M, 2015-2019

	2015	**2016**	**2017**	**2018**	**2019**
H&M group	25.61	23.79	20.15	21.93	22.76
INDITEX S.A.	32,55	32,7	30,11	26,68	22,02

Source: Own calculations based on the data from annual reports 2015-2019

Earning per share ratio of Inditex was constantly increasing throughout the given period. Starting with 0,923 in 2015, the company reached the result of 1,168 by the end of 2019. The gradual increase indicates that the company is getting more profitable with each year as well as its increasing profits to distribute to its shareholders. As the company's earnings per share were rising, so did Inditex's market value per share.

Table 16 Comparison of Dividend yield of Inditex and H&M, 2015-2019

	2015	**2016**	**2017**	**2018**	**2019**
H&M group	3,01%	3,64%	4,95%	5,82%	4,61%
INDITEX S.A.	1,54%	1,99%	2,23%	2,60%	3,61%

Source: Own calculations based on the data from annual reports 2015-2019

The represented results of dividend yield show what percentage of the stock's market price was paid back in the form of a dividend each analyzed year. The indicators were progressive for Inditex during the period of 2015-2019. Starting with 1,54% in 2015, the company reached 3,61% by the end of 2019. However, the number per each year were considerably lower than its competitor's results. There was an increase of the return of invested capital for Inditex during 2015-2019, but in comparative analysis with its main competitor, the company is falling behind.

In the table above, the equity value of each common stock issued by the analyzed company can be seen. Book value indicator was chosen for this purpose. It adjusts the historical cost of the asset by the accumulated depreciation. The trend of book values are strictly progressive during the period of 2015-2019. Starting with 3,36 per share in 2015, Inditex showed the result of 4,71per share by the end of 2019.

According to the additional financial data and the company ratings, the fortune of the holding beneficiary decreased by $1.3 billion according to the Forbes rating. The reason for this is the fall of the company's shares in 2018 to a record low in three years at 25 euros per share. The collapse of Inditex shares occurred after JP Morgan reduced the target price of Inditex assets by 6.5% (from €38 to €35.5 per share), comparable sales never increased by the promised 6%, because the main competitors GAP and H&M greatly reduced prices to eliminate their stock. In 2019, there is the same trend of slowing down the company's capitalization growth.

4.10 Altman Z-score

According to the reviewed literature, Altman Z-score predicts the company's likelihood of bankruptcy in the next few years. The calculations for Inditex presented below were done through the five-factor model's formula using the values of following items: total assets, working capital, retained earnings, EBIT, total equity, total liabilities and revenue.

The highest Altman Z-score was performed in 2015, as 4,63. With the worldwide expansion and development of the company the risks become higher. As it can be seen from the table, the results of following year were slightly lower. However, they never fall close or below the threshold of green zone marked as 2,99. The results of degressive period 2016-2017 lay far above the 2,99. Moreover, the company managed to perform better score of 4,46 in 2018, starting the progressive trend, which resulted in 4,53 score by the end of 2019.

Proceeding from the Altman Z-score analysis, it can be concluded that Inditex was in the condition of financial stability during the period of 2015-2019. The company's scores are far above the bankruptcy threshold of 1.81. Consequently, Inditex is at low risk of bankruptcy.

Figure 14 Altman index of Inditex, 2015-2019
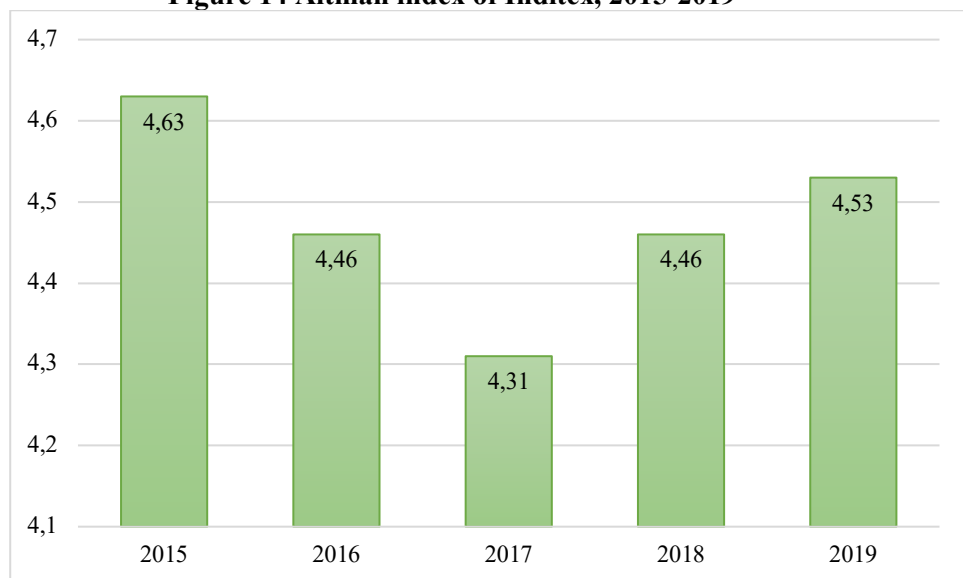
Source: Own calculations based on the data from annual reports 2015-2019

4.11 DuPont Analysis

The Dupont model presented below breaks down the return on equity ratio of Inditex. The analysis is based on three main items: profit margin, total asset turnover, financial leverage. The changes of these values change the return on equity of the company.

Table 17 DuPont analysis of Inditex, 2015-2019

	2015	2016	2017	2018	2019
ROE	**27,7%**	**27,9%**	**26,7%**	**25,1%**	**24,5%**
Profit Margin	13,9%	13,7%	13,4%	13,0%	12,7%
Asset Turnover	1,36	1,34	1,29	1,29	1,30
Leverage	1,47	1,52	1,54	1,50	1,48

Source: Own calculations based on the data from annual reports 2015-2019

In the table above, the behavior of ROE components can be seen. In 2015, the company raised its ROE by maintaining a high profit margin and increasing the asset turnover in comparison with the following years. In 2016, Inditex was leveraging assets more effectively than in 2015, so the leverage increased its contribution to ROE, where it showed the highest percentage of 27,9%. This tendency lasted through the year 2017, as a result of which Inditex had the most effective asset leverage 1,54 of the analyzed period. However, asset turnover input and profit margin decreased in 2017, so the ROE value started its decreasing tendency, which lasted till the end of 2019. Inditex performed the lowest ROE value in 2019, 24,5%, which was the result of substantially lower profit margin and asset leverage. There is an assumption that this year, the increase in asset turnover was not as effective due to underperformance two other components.

5   Results and discussions

The thorough financial analysis of Inditex was performed. The review of the clothing retail industry as well as the research of Inditex's structure and processes were conducted. According to the results, Inditex is one of the most successful companies in the clothing industry. The company is expanding rapidly, capturing new markets each year. Along with the successes, the company went through a number of challenges of the retail industry. In the following subchapters, those challenges and wins of the company will be summarized.

5.1   Strength of the company

The secret to the success of Inditex is simple innovative approach to production and distribution models with the fast fashion industry. This allows to achieve phenomenal speed in the development of new products. Inditex, thanks to its low prices and broad product choices, constantly attracts new customers. The average customer visits the store about 17 times a year. It is currently expanding its activities in Asian countries. Most of the key economic indicators of the corporation increase annually. About 500-600 new stores are opened every year.

The period of 2015-2019 is mostly characterized by steady growth in financial and operational indicators, growth in market value and, in general, positive dynamics. Inditex continued to follow its long-term strategy and developing a global network of fully integrated stores and online platforms. The company remained active in differentiating its stores.

Inditex is developing further its successful e-commerce strategy. For example, a subsidiary brand Zara launched the online platform in countries such as Brazil, Egypt, Indonesia, Israel, Lebanon, Morocco, Serbia, the UAE, Kuwait, Jordan, Colombia and Ukraine. In this regard, in the 2019 financial year, Inditex achieved high operational performance:

- Net sales reached 28.3 billion Euros;
- Sales in local currency increased by 8%;

- LFL1 sales increased by 6.5% compared to the previous period (+ 4% in 2018).

The growth in the revenues was due to the investments in the development of electronic commerce of the company's owner, billionaire Amancio Ortega.

In 2019, the company's total trading area reached 5,086,732 square meters. The largest area and one of the largest growth indicators belong to the Zara brand. It can be explained by the fact that Zara is popular both among the mass market and the premium segment, consequently it brings most of the profit.

Based on the company's expenses during last years, operating expenses decreased significantly despite the expansion strategy. This was influenced by the introduction of effective management and optimization of production, as well as the closure of some stores in Asia and America.

Another factor that contributed to high growth of financial indicators was the autonomy of Inditex in management, which allowed each brand to make decisions independently. However, they were united from the organizational point perspective.

5.2 Weaknesses of the company

There are many risks that Inditex may face. Mainly those are business environment risks coming from external factors as economic and demographic changes. The best way to face those risks would be not the physical expansion worldwide, but the strong online presence.

As Inditex follows the fast fashion concept, it constantly tries to adjust to changing fashion monthly changing trends. The shortcoming of apparel retail that the goods would not be sold if they do not satisfy fully customers´ expectations, which are changing very rapidly as well. The problem is overproduction of goods, which most of the time goes to waste. Within the last five years Inditex is actively involved in sustainability movement: a fraction of unsold goods goes to recycling and upcycling every month. However, it does

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[1] Like for like (LFL) is an indicator that compares the current and previous period, excluding objects (stores) that are not present in one of the periods. It allows to evaluate the dynamics of changes in the main business without taking into account its organic growth, which is opening stores.

not fully satisfy a modern customer with high exposure to environmentally friendly items of more sustainable competitors.

As it was mentioned in the previously in the company overview, Inditex is a very centralized company with vertical integration. The main managing units are based in 12 logistics centers, all in the territory of Spain. It keeps the Spanish and overall European revenues high. However, the global influence of the company is rather weak due to lack of control centers in other continents.

As a result of analysis of the alternative resources different from the annual reports, it was concluded that Inditex has rather weak human resources policy. Employees of entry and mid-level jobs reported about low wages and long hours of work. Currently, in the clothing retail industry, part-time and temporary contracts are very popular. Inditex is one of the main abusers of this trend. According to Glassdoor anonymous reviews, the high number of employees shared the other drawback of the company, such as lack of promotion opportunities and lack of a system of contribution to product improvement.

The pricing strategy of Inditex, changed drastically throughout the history of its development. Its different brands cover different segments of target audience. However, the prices are not adjusted to the local markets. The prices appear to be rather high in many countries of presence. The reason might be the base of pricing strategy which is retrieved from purchasing power of European customers mainly. Comparison of average prices of Zara, the flagship of the company, with its direct competitors is represented in the graph.

Figure 15 Pricing strategy comparison of Zara, Mango, H&M, 2019

Sources: https://retviews.com/
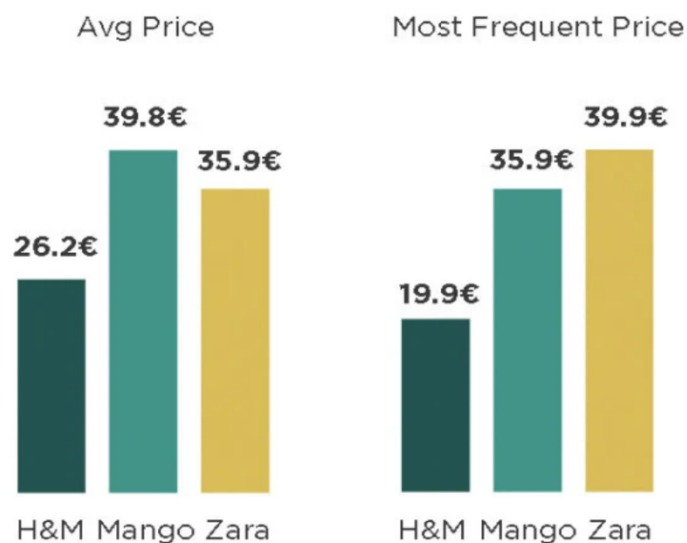
Poor quality of goods is the main shortcoming of many representatives of fast fashion industry. With global expansion and mass production Inditex has to neglect many factors contributing to the product quality. The company keeps investing in warehouse and tracking technology such as RFID, pro-environment movements. The prioritized investment affects the whole production and supply chains, where poor working conditions are often the reason of lowering quality of goods.

Conclusion

The Diploma Thesis pursued the object of financial performance evaluation of multinational clothing company INDITEX during the period of 2015-2016. The research consisted of the main theoretical and practical parts. In the theoretical part, the theory behind the thesis was explained. The reviewed literature specified fundamental terms, theories and methods of financial analysis.

The practical part contained the description of the company's background, its organisational stracture. It specified Inditex's production processes, sales strategies and marketing activities.The second half of the practical part was focused on implementation of financial analysis through horizontal analysis, vertical analysis, financial ratios, Dupont analysis and Altman's Z-score model.

The analysis followed the purpose of specifying the effect of INDITEX's fast fashion approach to its financial well-being. According to the provided research Inditex found to be the most influential clothing retailer in Spain and one of the world's fourth largest fashion chains. The company owns clothing brands ZARA, Pull and Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home, Uterque, Zara Kids, which are among the most successful in the world. 7490 stores operate in more than 96 countries, of which 2131 belong to ZARA brand stores. It is considered to be one of the most studied brands in Europe.

The work was focused on the effectiveness of the financial and economic activities of the company within 2015-2019. The practical part identified some of the factors affecting the efficiency of the corporation's financial activities. The component parts of the company's return on equity were identified. The companies ROE was slowly decreasing throughout the years. As a result of Dupont analysis, the financial activities, which are contributing the most to the changes in the return on equity were identified. It was found that the companies' activities are rather conservative and low risk. The contributing factors, as profit margin, total asset turnover, financial leverage, were constantly varying. However, the financial leveraging was not used effectively.

According to the analysis of company's expenses during last 5 years, operating expenses of Inditex decreased significantly despite the expansion strategy. This was highly impacted by the introduction of effective management and optimization of production, as well as the closure of some stores in Asia and America.

The company's likelihood of bankruptcy was tested in the practical part of the work. Proceeding from the Altman Z-score analysis, it was concluded that Inditex was in the condition of financial stability during the period of 2015-2019. The analysis proved that Inditex is at low risk of bankruptcy.

The share price of Inditex was evaluated as a result of market value ratio analysis. Earning per share ratio of Inditex was constantly increasing throughout the chosen period. As the company's earnings per share were rising, so did Inditex's market value per share. The gradual increase indicated that the company was getting more profitable with each year as well as its increasing profits for distribution to its shareholders.

As a concluding section of the practical part, the corporation's strength and weaknesses were analyzed.

In 2005, the company announced that it had become a world leader in the fashion industry. Since then, Inditex has continued its impressive growth. For more than 50 years, this company, created by businessman Amancio Ortega Gaona, has been a bright star in the world of fashion industry.

The conducted financial analysis of Inditex fulfilled its goals and objectives set in the beginning of the research. As a result, this diploma thesis represents a comprehensive independent investigation of Inditex's financial performance.

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Appendix

Appendix 1 Key items of INDITEX S.A. from Consolidated Balance Sheet for 2015-2019, in million Euros

	2015	2016	2017	2018	2019
Cash and cash equivalent	3798	4225	4116	4931	4866
Current Financial investments	222	1086	2037	1472	1929
Other financial assets	169	46	87	12	20
Other current assets	127	139	141	160	162
Income Tax Receivable	68	89	107	110	108
Trade and other receivables	862	669	861	778	820
Inventories	1859	2195	2549	2685	2716
Total Current Assets	**7105**	**8449**	**9898**	**10148**	**10621**
Rights over leased assets	531	504	505	457	464
Other intangible assets	153	190	211	255	346
Goodwill	198	194	196	207	206
Property, plant and equipment	6041	6597	7283	7644	8339
Investment property	81	21	21	21	20
Financial investments	151	184	231	237	267
Other non-current assets	472	524	554	520	564
Deffered tax assets	644	693	722	744	858
Total Assets	**15377**	**17357**	**19621**	**20231**	**21684**

Sources: Inditex.com

Appendix 2 Key items of INDITEX S.A. from Consolidated Balance Sheet for 2015-2019, in million Euros

	2015	2016	2017	2018	2019
Equity	**10469**	**11451**	**12752**	**13522**	**14682**
Equity attributable to the Parent	10431	11410	12713	13497	14 653
Equity attributable to non-controlling interests	38	41	38	25	30
Non-current Liabilities	**1159**	**1236**	**1419**	**1536**	**1618**
Provisions	201	145	242	259	229
Other non-current liabilities	716	805	920	1005	1072
Financial debt	2	749	0	4	5
Deferred tax liabilities	241	285	257	268	312
Current Liabilities	**3749**	**4670**	**5451**	**5173**	**5383**
Financial debt	8	10	62	12	84
Other financial liabilities	83	68	64	105	47
Income tax payable	150	77	230	151	153
Trade and other payables	3508	4514	5095	4906	5099

Total equity and liabilities	15377	17357	19621	20231	21684

Appendix 3 Key items of INDITEX S.A. from Consolidated Income Statement for 2015-2019, in thousand Euros

	2015	**2016**	**2017**	**2018**	**2019**
Net Sales	20900439	23310532	25336000	26145000	28286000
Cost of sales	8811139	10031982	11076000	11329000	12479000
Gross margin	12089300	13278550	14260000	14816000	15806000
Operating expenses	7391832	8175581	8944000	9329000	8176000
Other losses and income, net	1691	19548	38 000	30 000	33 000
Gross Operating profit (EBITDA)	4699159	5083420	5277000	5457000	7598000
Amortisation and depreciation	1021717	1062686	963 000	1100000	2826000
EBIT	3677442	4020734	4314000	4357000	4772000
Financial results	10069	9997	5 000	17 000	152 000
Results o f companies accounted for using the equity method	55607	47588	42 000	54 000	61 000
Profit before taxes	3743118	4078319	4351000	4428000	4681000
Income tax	860917	917214	979 000	980 000	1034000
Net income	2900000	3200000	3400000	3400000	3600000
Earning per share in Euros	0,923	1,014	1,082	1,106	1,168